THE US-EU REGULATORY DIALOGUE: THE PRIVATE SECTOR PERSPECTIVE

HEARING

BEFORE THE

SUBCOMMITTEE ON
DOMESTIC AND INTERNATIONAL
MONETARY POLICY, TRADE AND TECHNOLOGY

OF THE

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THURSDAY, JUNE 17, 2004

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THE US-EU REGULATORY DIALOGUE: THE PRIVATE SECTOR PERSPECTIVE

Thursday, June 17, 2004

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC AND
INTERNATIONAL MONETARY POLICY,
TRADE AND TECHNOLOGY
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:02 a.m., in Room 2128, Rayburn House Office Building, Hon. Judy Biggert [acting chair of the subcommittee] presiding.

Present: Representatives Biggert, Feeny, Maloney and Hooley. Also present was Representative Bachus.

Chairwoman BIGGERT. [Presiding.] This hearing of the Subcommittee on Domestic and International Monetary Policy, Trade and Technology will come to order. Without objection, all members's opening statements will be made part of the record. I will recognize myself for 5 minutes for an opening statement.

Good morning. It is my pleasure to chair this hearing on the US-EU Regulatory Dialogue: The Private Sector Perspective. I want to thank Chairman Oxley for his leadership on this issue and for focusing attention on the growing dialogue between financial regulators on both sides of the Atlantic. There is no doubt that increased interest in the dialogue reflects the growth in economic and financial activity on both sides of the Atlantic, and the interdependency of those growing markets.

It is because of that increased interest and interdependency that we are conducting this second hearing today. Held at the full committee level last month, our first hearing featured those who are official parties to the dialogue. Government officials from both the U.S. and the EC had the opportunity to share their views on the status and outstanding challenges that the dialogue will address in the near future.

Today, we hear from those who are not official parties to the dialogue, but who nonetheless have much to add to its future success. It is the private sector's turn today, and representatives from the banking and securities markets, as well as academia, will have the opportunity to voice their views on how the dialogue should evolve.

One of the great strengths of our capital markets in the United States is the active engagement of our private sector in the shaping of emerging laws and regulations. Their involvement can help us ensure that our system responds quickly and efficiently to market

developments, while at the same time preventing abuses. We look forward to hearing those views today.

As we seek to work more closely with our economic partners in Europe, some in the private and public sectors have increased their calls for greater trans-Atlantic harmonization in regulatory standards. I continue to believe that case-by-case determinations make more sense than would a wholesale commitment to harmonize, regardless of topic or market structure. I agree with Chairman Oxley that convergence for convergence's sake is not a wise public policy choice. I also doubt that one must endorse convergence up front in order to achieve greater comparability and mutual understanding. The success of the dialogue to date has proven this.

Besides addressing the issues of convergence, next steps, and inclusion of other parties in the dialogue, there is an issue whether the U.S. government is structured appropriately to represent our best interests in the dialogue. I look forward to testimony from our witnesses on whether the dialogue, our EU counterparts, or other mechanisms for US-EU cooperation are adequately open to views from the private sector. I look forward to considering whether the U.S. Treasury structure in Europe, with attaches in Paris and Frankfurt, but not Brussels and London, is consistent with the shifting centers of economic power in Europe during the 21st century.

Specifically, London and Brussels represent the financial and political capitals of Europe, yet our Treasury Department still posts representatives in Frankfurt, the location of the European Central Bank, and Paris, the location of the Organization for Economic Cooperation and Development. As important as these missions may be, times have changed and centers of influence and activity have changed, yet our resource allocation apparently has not changed.

Financial markets are the engine for economic growth in any economy. The U.S. and the EU mutually benefit from economic integration as consumers and businesses find new products and services available to finance their productivity activity. Government's role is not to stand in the way of productive activity. Its role is to find a way of ensuring that minimum common standards protect the system from abuses.

Our witnesses will provide perspective on whether an appropriate balance is being struck in Europe and what the U.S. government can do to better address our goals. I look forward to hearing suggestions and to advancing the dialogue that is so important to our economic future.

With that, I would recognize the ranking member for 5 minutes.

Mrs. MALONEY. I thank the gentlelady for yielding. I request permission to put my opening statement in the record in the interest of time.

I would like to take this opportunity to welcome a fellow New Yorker who will be testifying today, the chairman of the Securities Industry Association, Richard Thornburgh. Mr. Thornburgh is the chief risk officer for Credit Suisse Group and a member of the Credit Suisse Group executive board. The Credit Suisse Group through CSFB may be the quintessential trans-Atlantic firm with operations in Europe and the United States. It has global capabilities, with offices in 35 countries.

It is clear from Mr. Thornburgh's background that he has a great deal of experience and expertise on the issues before us today. I look forward to his testimony. I would also like to congratulate Credit Suisse on celebrating 70 years of service in our country. Founded on June 15, 1934, it was the first public securities firm after the creation of Glass-Steagall and they are an outgrowth of the First Boston Group.

I might also add that Credit Suisse is a major civic leader in the city that I am proud to represent, employing over 6,000 New York residents and participating in the civic fabric of our city. We thank him for being here and for your service to safety and soundness in our financial institutions, and we look forward to your testimony.

Thank you.

Chairwoman BIGGERT. Thank you very much.

Does the gentlewoman from Oregon have an opening statement?

Ms. HOOLEY OF OREGON. I do not, Madam Chair, but I would like to introduce one of the panelists, if this is the time you want me to do it.

Chairwoman BIGGERT. Please proceed.

Ms. HOOLEY OF OREGON. Thank you.

Thank you, Madam Chair and Ranking Member Maloney for holding this hearing today on the European Union-United States regulatory dialogue. It is important that we address issues that are facing U.S. financial firms doing business in the EU, and to make sure that there is an ongoing and healthy dialogue between the United States and the EU officials.

I am honored to be joined by a fellow Oregonian who is testifying today on behalf of private enterprises. Paul Oldshue has been living in Portland, Oregon since 1978. He has been a productive and energetic member of our community. He is the executive vice president and manager of U.S. Bancorp's International Banking Group. Prior to joining U.S. Bancorp in April of 1991, Mr. Oldshue headed PacifiCorp Financial Services Broker-Dealer, led Security Pacific Bank's Oregon Commercial Lending Group, and served as treasurer of Orbanco Financial Services Cooperative.

Mr. Oldshue has a BA degree from Williams College and an MBA from New York University School of Business Administration. So he is from your area, Ranking Member Maloney. He is past president and director of the Arc of Multnomah County, immediate past president and director of the Bankers Association for Finance and Trade.

I am very happy that you have decided to join us today, and look forward to your perspective on the ongoing regulatory dialogue between the EU and the United States. Thank you for being here.

Chairwoman BIGGERT. Thank you very much.

I guess I am left to introduce the final witness here. Professor Hal Scott is the Nomura professor and director of the Program on International Studies at Harvard Law School. Mr. Scott is the author of several books, including one recently published on international financial policy and regulation. Professor Scott is also a governor of the American Stock Exchange and a member of the American Enterprise Institute Shadow Financial Regulatory Committee.

There is some tie to my home State of Illinois. In fact, he has been working with Ken Dam, who is the Max Pam professor of law at the University of Chicago. So I guess I will say that we have somebody that is within this realm.

With that, let me just say that without objection, your written statements will be made part of the record, then you will be each be recognized for a 5-minute summary of your testimony. Following that, then we will recognize for 5 minutes each the members of the committee to ask questions. So we will begin with Mr. Thornburgh. You are recognized for 5 minutes.

STATEMENT OF RICHARD THORNBURGH, CHAIRMAN, SECURITIES INDUSTRY ASSOCIATION

Mr. THORNBURGH. Madam Chair Biggert and members of the subcommittee, thank you for your continued interest in the US-EU financial markets dialogue and the EU financial services action plan. My testimony today will stress the following points:

One: The EU capital markets are a critical source of capital for U.S. companies and vital to U.S. investors seeking portfolio diversification.

Two: a U.S. action plan is needed to complement the FSAP implementation.

The US-EU financial markets dialogue is working. We need to build on what is now in place. We commend the Treasury Department for opening a specific dialogue on financial services issues. The US-EU relationship provides the U.S. securities industry and its clients with tremendous opportunities. The EU offers U.S. investors alternative investment options for portfolio diversification. For example, U.S. investors own more than $1.3 trillion in foreign stocks, of which over $700 billion or 53 percent are EU shares. U.S. holdings of EU bonds total more than $227 billion, or 45 percent of total foreign bond holdings.

The EU also offers U.S. companies an alternative pool of capital for raising debt and equity. Last year alone, U.S. companies raised $164 billion in debt and almost $7 billion in equity in the EU.

Looking forward, we suggest a coordinated U.S. interagency effort, or otherwise known as a U.S. action plan to fully and effectively engage EU governments and regulators at all levels about the need for open and competitive markets. Our action plan includes, one, the establishment of a Brussels attache; two, increased Treasury coordination with the State Department; three, further U.S. Congress-EU Parliament contacts; and four, coordinated SEC-CESR focus on regulatory conversions.

First, we strongly believe that the U.S. Treasury Department should place a financial attache in Brussels. Such a post would advocate U.S. industry interests and support the dialogue. In this regard, we support additional funding to bolster Treasury's ability to advocate U.S. interests in the global marketplace. The expected pace of change in the EU financial market over the next years justifies this type of focused presence at the center of the newly expanded EU.

Second, Treasury clearly has the leadership role in the dialogue. We believe, however, the U.S. State Department through its embassies and consulates in all 25 member states can enhance and

support Treasury's efforts. This activity is essential because individual EU member states can and often do play a pivotal role in key EU legislative decisions.

Third, we firmly endorse the further development of greater understanding and closer relationships between key financial services legislators in the U.S. Congress and the European Parliament. We believe these efforts should encourage constructive discussion of existing extraterritorial issues such as Sarbanes-Oxley and the EU's financial conglomerates directive; facilitate and encourage mutual prior consultation on legislation with potential extraterritorial effects to help prevent future conflicts; and identify common future legislative goals and common solutions wherever possible.

Finally, we welcome the new SEC-CESR effort for cooperation and collaboration. SIA's support of this regulatory dialogue is consistent with the industry's goal to minimize regulatory differences and improve the efficiency of the trans-Atlantic markets through regulatory convergence. To this end, SIA has proposed a number of issues that could be resolved in the near term to mutually benefit the marketplace. The areas in which we have suggested that the SEC and CESR study convergence are, one, public offering documents beginning with nonfinancial disclosure; two, broker-dealer registration requirements; three, rules relating to credit rating agencies; four, international anti-money laundering standards that not only promote uniformity and cooperation and efficacy, but also allows for reliance on financial intermediaries across borders; and five, corporate governance standards.

Lastly, the U.S. securities industry still has significant concerns about the implementation of the EU's financial conglomerates directive. We urge the subcommittee to monitor the situation carefully.

The U.S. securities industry plays a vital role in the EU capital markets and is fully committee to the integration of those markets. We look forward to working with the EU, the administration and this subcommittee in achieving a European capital market that is transparent, open and efficient.

Thank you. Madam Chair, please allow me one personal comment. I also want to take this opportunity to thank the members of the committee on the fine work that you have done on the Basel II capital accords. The public discussion of these issues in both the House and the Senate has had a tangible impact that has moved the Basel Committee to a place where a large portion of the overwhelming problems we faced 18 months ago have been resolved. The House Financial Services Committee was the first to publicly discuss those issues. My firm and the industry are appreciative of your efforts.

[The prepared statement of Richard Thornburgh can be found on page 57 in the appendix.]

Chairwoman BIGGERT. Thank you very much. That is nice to hear.

Our next witness is Mr. Oldshue.

STATEMENT OF PAUL OLDSHUE, IMMEDIATE PAST PRESIDENT, BANKERS' ASSOCIATION FOR FINANCE AND TRADE

Mr. OLDSHUE. Chairman Biggert, Ranking Member Maloney and members of the committee, I am pleased to be with you today to discuss the banking industry's views regarding the financial markets dialogue between the United States and the European Union. Regulation of financial products and services imposes additional costs on financial firms and affects their customers' cost of capital.

Unnecessary regulatory conflict, inconsistency and duplication can only add to those costs, and those of us in the financial services business strongly support the efforts of U.S. and EU officials to limit regulatory dysfunction. We are grateful for this hearing and for the full committee's earlier hearing on May 13 to examine this important subject.

I am testifying today as the immediate past president of BAFT, the Bankers' Association for Finance and Trade. BAFT is an affiliate of the American Bankers Association and its membership includes most of the major American banks that are active in international banking, and also many of the major international banks chartered outside of the United States.

My employer, U.S. Bancorp is the seventh-largest financial services holding company in the United States. Our principal bank subsidiary, U.S. Bank, operates in 24 states throughout the Midwest and West. We maintain correspondent relationships with more than 2,000 banks in 125 countries.

The United States and the European Union have a close economic relationship, and close cooperation should be good for both of us. There is no doubt that the US-EU financial markets dialogue has been a constructive exercise and that it has accomplished a great deal simply by establishing new lines of communication. Moreover, since the dialogue began in March 2002, discussions between U.S. government and EU officials have contributed to resolution of a number of important issues arising in the context of the EU's financial services action plan.

We think that this is a good start. We believe that the value of the dialogue will increase as it continues and as relationships deepen and issues are added. But more can be done, and we think the dialogue can be improved in several respects.

We feel that the dialogue should be more transparent. It would be a big improvement if U.S. participants made a greater effort to consult with U.S. banks, securities firms and other financial firms early in the process and on an ongoing basis. This would give us a chance to provide our views as to what should be on the agenda and what the priorities should be, in our view.

We also think that participation in the dialogue should be broadened. The dialogue should include financial regulators and also members of Congress and staff, particularly those who are on this committee. We think much could be gained if the members of Congress and their staffs engaged in a continuing dialogue with appropriate officials in the EU, again with input from the private sector.

We would also like to recommend that the U.S. Treasury Department consider putting more of its people on the ground in Europe. In my experience, there is nothing like local knowledge in order to anticipate, understand and react to new developments in particular

markets. Treasury should seriously consider adding staff in various locations in Europe, particularly in Brussels.

I would like to mention several specific issues that concern the banking industry that are or should be on the dialogue's agenda.

They include implementation of Basel II. Bankers are concerned that there could be significant differences in the application of Basel II from country to country, and that these differences could impede banking across national borders. To address our concerns, we recommend that the US-EU financial markets dialogue include a discussion of how to coordinate the application of the new capital standards.

We are also concerned about convergence between the U.S. GAAP and international accounting standards. In this respect, we recommend that the dialogue focus on three particular areas: first, lack of transparency in the IASB's rulemaking process; secondly, the potential shortcomings of principles-based accounting, which can become inconsistent if the principles are interpreted differently by those who apply them; and last, weighing the costs and benefits of convergence of existing accounting rules.

Another issue that merits attention is privacy and data protection. Specifically, we are concerned about the potential impact on U.S. banks and other financial institutions arising out of the European Union's directive on data protection. A stand-still agreement between the EU and the United States expired on July 1, 2001, leaving U.S. banks and other financial firms vulnerable to action by government authorities in the EU countries. EU restrictions on information-sharing across corporate affiliates would affect U.S. financial firms more than their European counterparts because financial organizations in the United States tend to have more separately incorporated entities than the European universal bank model. We are eager for the EU to acknowledge that the Gramm-Leach-Bliley Act and other financial privacy laws such as the recently enacted Fair and Accurate Credit Transactions Act provide adequate privacy protection for personal financial information.

In conclusion, we strongly support the US-EU financial markets dialogue, but also believe it can be improved in various respects. We also have specific issues that we would like the dialogue to address. We are very encouraged by the progress that has been made so far, and enthusiastic about the potential that the future holds.

Thank you very much for holding this important hearing and allowing us to participate and provide our input. Thanks.

[The prepared statement of Paul Oldshue can be found on page 28 in the appendix.]

Chairwoman BIGGERT. Thank you very much.

Professor Scott, you are recognized for 5 minutes.

STATEMENT OF HAL SCOTT, PROFESSOR OF INTERNATIONAL FINANCIAL SYSTEMS, HARVARD LAW SCHOOL

Mr. SCOTT. Distinguished members of the committee, thank you for permitting me to testify today on matters relating to the informal US-EU financial markets regulatory dialogue. I will be reading from a statement prepared by myself and Kenneth Dam.

Let me summarize our views. While the dialogue has made a significant contribution to better relations with the EU, it has failed

to resolve the most important issue confronting the two markets: whether or not the U.S., like the EU, will accept international accounting standards. We also believe the dialogue should be more proactive in removing obstacles to the development of what we call an efficient trans-Atlantic market in financial services. Its work should not be limited to firefighting.

Finally, we believe that the dialogue needs to include additional government participants and to become more transparent. The most successful result of the dialogue has been to temper the application of Sarbanes-Oxley to foreign firms, some of which had great difficulty in simultaneously complying with the new Act and their own laws. The SEC sought to accommodate these firms by adopting a flexible approach to the Act's requirements.

The dialogue had no formal role in this regulatory process. However, we believe the presence of the Treasury's broad perspective on US-EU relations and its deep concern with the health and efficiency of capital markets may have contributed to the willingness of the SEC to react sympathetically to EU concerns. In this sense, the dialogue is as much an internal process among U.S. regulators as it is an external process with the EU.

The most noteworthy shortcoming of the dialogue is its failure to resolve a potential crisis that may be precipitated by the EU's anticipated adoption of international accounting standards in 2005. Currently under SEC regulations, foreign firms may only issue securities or have their securities traded in the U.S. public markets if such firms either state their accounts in or reconcile their accounts to U.S. GAAP.

Absent a change in SEC policy, EU firms which state their accounts in IAS will be unable to access the U.S. public market. This could lead the EU to take the position that U.S. firms could no longer use U.S. GAAP in the EU market. This could have a severe effect on U.S. firms issuing capital abroad and further increase the segmentation between the U.S. and EU markets. This is an important issue that must be resolved.

We believe the dialogue should be broadened beyond solving particular problems, to embracing the positive agenda of creating a single trans-Atlantic market in financial services. The goal of this effort would be to remove barriers to cross-border transactions, particularly in capital markets where significant barriers remain. The EU is now in the process itself of adopting a common prospectus and a common approach to continuous disclosure through the implementation of two new directives. Further, it has created a new body, the Committee of European Securities Regulators, CESR, to facilitate these efforts. The SEC should start working with CESR to harmonize disclosure rules so that the two sides could develop a common trans-Atlantic prospectus and ongoing disclosure rules.

There is also much to be done in creating common distribution rules and a coordinated approach to market structure. Finally, there is also a need for further thinking on ways to resolve enforcement differences between the two sides of the Atlantic. A joint SEC-CESR committee could also work on these matters.

In our view, an effective trans-Atlantic market in financial services would be best achieved through common regulatory rules and enforcement throughout the U.S. and EU. We do not believe the

equivalence alternative offered by the EU is workable for rules pertaining to the offering of securities. The equivalence approach would require the U.S. to allow EU firms to offer securities in the U.S. under EU rules, which include the rules of various member states as well as the EU's own rules. This home country approach for securities offerings has not even worked within the EU, and is in the process of being replaced by harmonized rules in the form of the common prospectus.

We conclude with a few thoughts on process. The U.S. and EU should consider including the Commodities Futures Trading Commission, CFTC, and state insurance commissioners on the U.S. side. The EU also needs to have some member state representation. While EU financial regulation is significant, many important areas, like enforcement, are still left entirely to member states. We should also consider whether this should be a US-EU dialogue or a U.S.-Europe dialogue. If it is the latter, states like Switzerland and even Russia may need to be included in some fashion.

Thank you very much.

[The prepared statement of Hal Scott can be found on page 45 in the appendix.]

Chairwoman BIGGERT. Thank you very much.

We will now proceed to questions. I will begin.

The first question that I would like to ask is, Mr. Oldshue and maybe the other witnesses would like to give some answers on this also. Mr. Oldshue, I think that you present good arguments for increased transparency and participation among policymakers in Europe. However, I understand that a great deal of informal consultation and information exchanges already occur between members of the private sector and participants in the US-EU regulatory dialogue. Are you suggesting that a more formal structure is needed for these consultations?

Mr. OLDSHUE. I do not know that a more formal structure is needed. There have been conversations. There has been dialogue. I think from our perspective it has taken too much work to stay informed about the process. So an encouragement of continued openness and transparency and open dialogue and proactive dialogue in anticipation of problems is really what we are suggesting here.

Chairwoman BIGGERT. Concerning the transparency, what is the likelihood of the EU developing what we have here with the public comment period and publishing in the Federal Register? How important is the difference in taking public comment?

Mr. OLDSHUE. I think we are really not looking for there to be an identical process to what we have here. I think what we are looking for is an encouragement from your chair and from comparable chairs in Europe of an openness in dialogue in conversation on these points.

Chairwoman BIGGERT. I think you indicated that the US-EU regulatory dialogue should squarely address the privacy issues regarding the sharing of personal information within affiliates in Europe, especially after the passage of the FACT Act here.

Mr. OLDSHUE. Right.

Chairwoman BIGGERT. What reaction have you received from the U.S. and European regulators?

Mr. OLDSHUE. This is a fairly thorny issue. It really boils down to very different philosophies on how our financial organizations are structured and set up. We tend to conduct financial activities through separate and distinct subsidiaries of our holding companies that under U.S. law have restrictions on how they can share financial information from one to the other. European banks tend to be universal banks with everything under the same umbrella. The sharing of information is not similarly restricted or discouraged.

The difficulty a U.S. firm has in competing in that environment is that clearly as you are marketing financial products, it is a significant impediment to not be able to use information gathered in one part of the firm to market your products in another. This is not an issue that has an easy solution. I think from a regulatory perspective, it is going to boil down to allowing U.S. firms to share information across corporate entities so that they function in the same way as a European bank within its own corporate structure.

Chairwoman BIGGERT. Professor Scott, would you have anything to add to that?

Mr. SCOTT. I do not see the need to make the dialogue more formal than it is. But I think that we need to know more about what it is doing. I think that, as Paul has said, and it is my understanding that the U.S. participants widely consult the private sector before determining their positions, and that is good. I do not think that needs to be formalized, but I do think that it would be useful to have some regular reports, at least to the Congress, about what is going on in this dialogue. There is no formal process for reporting results, basic information, what are the issues on the table, what progress have we reached with respect to these issues. I think that that kind of transparency would be good to have, that kind of enhanced transparency.

Chairwoman BIGGERT. Thank you.

Mr. Thornburgh?

Mr. THORNBURGH. I guess there are really two parts of Paul's recommendation. I think one is that our own regulatory agencies and administrative agencies should reach out to our collective industry to seek input, as opposed to us trying to find the shadows in the closet. The second is the Lamfalussy process, which I think has made some good progress in Europe once it was put in place, which does call for more consultation. I think the UK regulatory law-setting process also has a very good consultation process which is equivalent to the U.S. But I think we would encourage our own agencies to seek out our input and we would complement the Lamfalussy process.

Chairwoman BIGGERT. Okay, thank you. My time has expired.

The Ranking Member, Mrs. Maloney from New York, is recognized for 5 minutes.

Mrs. MALONEY. Thank you.

I believe it was Richard Thornburgh who said in his opening statement that Brussels and London are important financial centers. I would like to add that we want to keep the United States as an important financial center. I am concerned about any rules, regulations, accords that in any way limit the ability for American business to compete and win in the world economy.

I am proud to have authored a bill that required Basel II to come back to the Congress for approval. It did not pass. It probably will not pass, but it got everybody's attention. We had several hearings on this important accord that is going forward. Some members that have testified before us believe that it will apply not just to our large international banks, but once you start a standard it starts applying to everyone. There is some concern from some of our financial institutions and businesses that the capital requirements will be stronger and harder on America than it will internationally.

Also, our regulators are very tough and they are very experienced and they are very good. Usually, it is a crook, when you have these scandals, it is someone who is just not following the regulations; it was an enforcement issue more than a regulation. So my point is, I am very concerned about Basel II. I think our regulators will enforce it. I am not so sure that Europeans and other countries will enforce it. We are going to be having a hearing, I think it is next week, on Basel II? Or is it Tuesday on Basel II? I hope that the leadership, the majority party, will invite the two gentlemen who made strong statements about their concerns to come back and testify at that hearing, too, so we can get their input.

I just would like to hear the comments from the industry representatives on Basel II and your concerns. Do you think it is fair? Do you think the capital requirements are going to be tougher on American firms? Your comments on that. The enforcement issue, it will be enforced on Americans. Will it be enforced in Europe. And also, I think your comments are very well taken that we need professionals in Brussels, in London, in the EU, really advancing and being part of the discussion so that we are in on the ground.

Thank you for your testimony and what you do for the country. On Basel II?

Mr. THORNBURGH. If I may make three comments, I think the first comment is it is very important that the FSA representing the European Community recognize the SEC as an equivalent regulator. I think the SEC's CSE proposal, which is put out for comment, clearly establishes an equivalent regulator and we have to keep our eyes on the fact that the FSA needs to make that determination this month in order for our firms to be able to comply with the capital directive.

Two is our concern would be on the whole area of operational risk. It has yet to be implemented. The allocation of operational risk among countries and subsidiaries will be a very tricky issue. That then leads to the whole home host issue in making sure that there is appropriate guidance so that the home regulator would have predominance over the host regulator.

I think, Paul, you have some more specific comments?

Mr. OLDSHUE. I would share your concern, Congresswoman, about the difficulties ensuring that the regulation is even and fair and consistent across borders. We do have capital standards in the U.S. that in many cases are more stringent than would be called for under Basel II. As Basel regulations are applied and regulated across borders, there is a risk that the standards could be different from country to country and bank to bank, and put our institutions at a competitive disadvantage.

We have recommended that the principle of lead supervision by a home country regulator be an objective. It would require that we defer to home country regulators, but I think it is a way of ensuring that information is shared across borders, that there is dialogue between the regulators, that we make every effort possible so possible that the regulations are the same and are applied consistently. This is the key issue from our perspective.

Mrs. MALONEY. I have asked this question at several hearings, and I have never gotten an answer that answers what I am really concerned about. Who is really looking out for American interests? In a sense, I do not think you really understand unless you have done the job yourself, no matter how good a regulator is. They do not know what it is like to be a major institution that is supplying capital in this country and across the world. Who is there to make sure that our interests are taken care of and that what you two are saying actually happens? Because the people there are not the real people in the field that understand what it is really like. Do you understand what I am saying?

Mr. OLDSHUE. Exactly. The Federal Reserve is the point agency.

Mrs. MALONEY. I know who is the point agency, but I think that they do not have the experience that someone like yourself has.

Mr. OLDSHUE. I think it is an issue. Our concern is that there be constructive and continuing and regular contact on these points. I think there is dialogue going on. Our concern is not so much that the Federal Reserve does not have an understanding of what our concerns are. Are concerns are really across borders and making sure that the things they do not really have direct control over are negotiated and implemented so that the various governments in the EU and other parts of the world are applying standards in the same kind of way.

I think they understand. It is a very thorny political issue.

Mrs. MALONEY. But how do we make sure that that happens?

Mr. OLDSHUE. I think it is cheerleading from your chair; it is an awareness that it is a significant issue. It is an awareness that as difficulties arise in implementing——

Mrs. MALONEY. How do you structurally work it into the format of the whole program?

Mr. OLDSHUE. I think it ends up needing to be an agreement between the regulatory authorities in the major financial markets. I do not know that you can legislate it.

Chairwoman BIGGERT. The gentlelady's time has expired.

The gentleman from Florida, Mr. Feeney, is recognized for 5 minutes.

Mr. FEENEY. Thank you, Madam Chair. I appreciate the testimony from the witnesses.

Mr. Scott, this is a hearing primarily about U.S. and European Union financial regulatory issues. You mentioned Switzerland and Russia for example as being European countries that are not currently part of the EU. Can you give us some perspective about our relationship with the EU and trying to break down some of the regulatory burdens and hurdles in terms of the global capitalization markets. Can you talk to us a little bit, even though this is a hearing about the EU relationships, about the Far East, for example, and the Mideast and other places where we have a significant

amount and growing percentage of our commercial market interchange.

Mr. SCOTT. You have a number of questions there. Let me start with the last one. Actually, I just got back from a symposium that I helped organize with Chinese counterparts on U.S.-Chinese financial relations. It is a major place in Asia, and I have done similar symposiums with Japan.

Interestingly, this term "dialogue" and "financial markets dialogue" has gotten over to China. This committee may be aware that the Secretary of Treasury has appointed a special emissary, I think unprecedented, to China, Ambassador Speltz, who also represents us with the Asian Development Bank. He is engaged in a financial markets dialogue with Chinese counterparts on solving specific issues in China.

So I think, while we are focused here on the US-EU, the Congressman is quite right to point attention to the importance of the Far East, China and Japan in particular. I think that the Treasury has been taking a productive lead in trying to resolve issues in those areas in which there are a number.

In terms of the question of the EU and Europe, the EU itself, Switzerland is obviously a major factor in Europe, as Mr. Thornburgh can readily attest.

Mr. FEENY. Especially when it comes to markets and transparency, right?

Mr. SCOTT. Yet, Switzerland is not part of the EU. The EU itself has had a number of outstanding issues with Switzerland, trying to resolve issues between them. Switzerland is an important part of the world's capital markets, an important part of the banking system, particularly in private banking.

So I think it would at least be worthwhile thinking about whether some kind of inclusion of the non-EU countries like Switzerland and Russia, which is going to be and is becoming a factor in world capital markets, need to be folded into this. Now, of course, then that raises the issue as to why are we doing this on a regional basis at all; why isn't this a worldwide effort; why US-EU; why not, U.S.-world.

I think that in the end, that is what we will try to achieve. But each region has its set of special issues. So I actually think that this kind of regional approach makes a lot of sense, but all the participants have to keep their eye on the bigger picture, which is the world capital market, and I believe they do. I think the people that we have participating from the U.S. side clearly are not just knowledgeable about Europe, because the Federal Reserve Board and the Treasury and the SEC are also concerned about the rest of the areas of the world.

Mr. FEENY. Thank you.

Another thing that you said that really interested me is that you suggested or implied there were some problems with what you called the "equivalence" approach where we sort of just acknowledge a home country's rules and regulations. But it seems to me, particularly a professor at the University of Chicago Law School, may see some advantages to having regulators compete. Maybe you can touch on how we get the best of both worlds so we have standards, but we also are not adopting the most onerous and rigorous

and anti-competitive standards available. Because often that is the way we descend as governments and regulators.

Mr. SCOTT. I should point out that I am the Harvard part of this team.

[Laughter.]

But lest you despair, I went to the University of Chicago Law School.

Mr. FEENY. Very good.

Mr. SCOTT. So I think Ken Dam and myself would share a common perspective, also being part of the Shadow Financial Regulatory Committee at the AEI. We are not generally in favor of more and more regulation and think markets should have the major role in determining what financial institutions do. That being said, I believe that in the area of securities offerings that this idea of regulatory competition is kind of theoretically attractive, but it just does not work.

Most financial firms would tell you that they would like common rules across all borders to do business. It is highly efficient. The question then becomes, well, if we have harmonized rules, where is the competition? How does the system change? I believe that there are always going to be ideas in competition. You do not need regulation in competition. As long as ideas are in competition, regulations can be changed.

Both sides of the Atlantic can continue to make very good suggestions about how those harmonized rules should evolve, but I think that the efficiency of our trans-Atlantic securities markets would be greatly aided by a common set of rules.

Chairwoman BIGGERT. Thank you.

The gentleman from Alabama, Mr. Bachus, is recognized for 5 minutes.

Mr. BACHUS. I thank the Chair.

Mr. Thornburgh, you have expressed a desire for a structured program of interaction between U.S. congressional members and their staffs, and their EU counterparts. What particular benefit do you think that type of exchange would provide that the current exchange of information does not?

Mr. THORNBURGH. The benefit that that kind of exchange acknowledges or allows for is a better understanding of why certain rules and regulations are being proposed, so that the rhetoric can be removed when people get caught off-guard. We clearly made some great compromises on Sarbanes-Oxley and the PCAOB, but if we would have had better discussions before those items came to the forefront, they could have been resolved with a lot less emotion and heat in the media and the press and in the marketplace, which I think can create some inefficiencies in competition and in markets.

Mr. BACHUS. Would you explain in detail your suggestion, I think you made a request for the placement of a Treasury financial attache in Brussels. How would that benefit the financial services industry here in the United States?

Mr. THORNBURGH. Thank you for the opportunity to address that question. I take this really from the perspective of the role that I have played. I moved to Switzerland in the late 1990s to become the CFO of a European company. My predecessor had lived in Lon-

don and commuted between London and Zurich to perform that function. What I learned from my personal experiences is to be an effective participant in shaping public policy and having an impact, one needs to live in the community. I think that the sign that the U.S. would make by moving the attache from Frankfurt to Brussels would acknowledge that Brussels is the heart of the EU legislative community. By having that permanent presence there, it shows a commitment and involvement in the community.

More importantly, it supports U.S. industry, not just the financial services sector, but U.S. industry. I think that ability to be around for the informal conversations which you all recognize much better than I do, would have a major impact in furthering the agenda for our economy and our companies.

Mr. BACHUS. Okay. You proposed in your statement a U.S. action plan. Would you explain why that is important and how we would formulate such a plan, what the mechanism would be for coming up with a plan?

Mr. THORNBURGH. The action plan really has four components. I think the first, as we have just talked about, is the Brussels attache. The second, which we have not really talked about, is Treasury coordination with the State Department. There are 25 EU member states and the new member states will have a major impact on how votes and decisions are made in the EU community. We have found out in the past in the financial services directive that although rules and regulations were proposed to the Parliament, they were voted down by a number of member states's ministries of finance.

So I think that ability to use the diplomatic corps to help us watch out for ourselves is a good attribute and addition to the treasury's coordination. We have talked about Congress and Parliament, and of course the last component is getting more communication, dialogue and action out of the SEC and CESR, which the professor I think has adequately addressed.

I would add, though, to the question from the Congressman from Florida, that I think accounting equivalency is important. We may not need equivalency in laws and maybe that is the wrong way to go, but I think accounting equivalency is extremely important to attracting foreign issuers to our markets.

Mr. BACHUS. Okay. What were some of the lessons learned from the ISD debate on market structure? There were some problems there that the private sector had. How do you think that could be resolved more successfully with this United States-EU dialogue?

Mr. THORNBURGH. Actually, the excellent lesson there was in fact that there was a group of southern core states of the European Union which took a different position from the more developed capital market states of the UK and Germany. What we found there is had we been using the State Department to be working on some of these issues, better progress would have been made, especially as it related to some protectionist aspects of the proposal, which really preserved the local stock exchanges in the southern states as opposed to helping create a more global European stock exchange or marketplace.

Mr. BACHUS. Okay. I see my time is up. I thank you.

Chairwoman BIGGERT. Thank you very much. We will start another round. Just briefly, I assume, Mr. Thornburgh, that the EU has assigned someone to our capital, an attache?

Mr. THORNBURGH. Yes.

Chairwoman BIGGERT. Thank you.

Professor Scott, do you believe that financial regulators in the U.S. and Europe currently have the legal authority to undertake the sharing of information and responsibility suggested not only by your testimony today, but also by some of the government witnesses at last month's committee hearing on the issue.

Mr. SCOTT. I think that most of the measures that I am focused on have to do with capital markets. The question would then be whether the SEC, which is our primary regulator, would have the legal authority to enter into agreements.

Chairwoman BIGGERT. It seems like each of the regulators's authority is based on laws enacted by their physical jurisdiction. So can they delegate or converge standards without seeking additional authority from the legislatures of the various countries?

Mr. SCOTT. Your focus is on the EU side as opposed to our side?

Chairwoman BIGGERT. Really on our side, too.

Mr. SCOTT. I have not looked into this in any detail, so I preface my remarks with that, but I would think that the SEC could not basically enter into any agreements, changing our basic approach to securities regulation, which might be required in an effort to harmonize the rules on both sides of the Atlantic, without authority from Congress.

So in that sense, the SEC could certainly entertain discussions, but at the end of the day if our securities regulations were to change in some ways that were different from what we currently have in our laws, there would be a need for additional congressional authority.

On the EU side, it is complicated by the fact that there is a split of authority between the EU and the member states with respect to a number of issues. I think I have already testified, for example, that enforcement is left almost entirely to member states in the EU. So the EU cannot really negotiate about enforcement without making some changes in the EU with respect to their authority to, at the European level, deal with enforcement. As I am sure you can appreciate, enforcement is what this is all about at the end of the day. We have already discussed that issue with respect to Basel. The same will be true with respect to securities regulation.

So I do not think that the EU is particularly well set up today to implement as opposed to discussing agreements that might be reached between the U.S. and EU. So some changes in legislative authority would be required on their side as well.

Chairwoman BIGGERT. Okay, thank you.

In today's testimony, we have heard recommendations that the US-EU regulatory dialogue be expanded to include the CFTC and members of Congress and the private sector. Would such an expansion make such a forum unwieldy and unable to reach decisions, if it gets too big?

Mr. SCOTT. At the risk of being unpopular here, I do not think I was advocating that the Congress participate.

[Laughter.]

Chairwoman BIGGERT. Okay. That is all right. We have enough work to do already.

Mr. SCOTT. I certainly think that the Congress should be kept fully informed and there should be regular reporting to the Congress, but I find it hard to envision how the Congress could actively be involved in these discussions in meetings. I just do not think that is particularly workable, but I think that the Congress needs to be fully informed.

I think it is very important that the insurance sector in particular, which is not represented here on this panel, get some inclusion in this process because I think that there are beginning to be a number of EU initiatives in the insurance sector which are already affecting U.S. insurance firms, and yet insurance regulators do not have any standing. As you know, this is a matter of state regulation, but I think we could try to find some ways, either through the trade associations or supervisors association of the insurance regulators, to get some representation on insurance. So I think that would be a very important expansion.

CFTC, I think, it also seems to me that they should be included. They are on the President's Working Group on Financial Markets, which is our internal attempt to coordinate regulatory activity. That being the case, I see no reason why they should be omitted from the informal dialogue with the EU.

Chairwoman BIGGERT. Okay, thank you.

Mr. Thornburgh, I believe in your testimony that you seek convergence across the Atlantic regarding anti-money laundering strategies, and that the trans-Atlantic business dialogue of which you are a member is making a similar recommendation. Could you provide us with a better sense of what kind of convergence you are recommending and how it could be achieved?

Mr. THORNBURGH. When we talk about convergence, I think we are talking about common rules and reporting requirements of those people who act as financial intermediaries. One of the complications, I understand, in the current setup is the inability to rely on a financial intermediary in another country to make a representation.

For example, at Credit Suisse First Boston we have to deal with the Swiss money laundering rules, the EU money laundering rules, and the PATRIOT Act. We deal with a client across borders so we may deal with a hedge fund based in Bermuda who wants to do a transaction with us in Switzerland; wants to do a transaction with us in the UK; and do a similar transaction with us in the U.S. There may be three legs of that transaction, so it is one transaction with three different booking centers.

The ability to allow us to rely on our own representations to ourselves is very important. I know from personal experience in a project we had to do for the FSA in the UK, we spent roughly $50 million to adhere to some standards in the UK, and after we did it the FSA told us, you know, we know realize it is too expensive; we will not make any of your other competitors go through the same process.

So we are all for the goal of catching the terrorists, catching the drug lords, but there should be some practical understanding of how institutional companies, dealing with institutions, might be

able to ease up the rules to get to the same result. Hopefully, that is enlightening.

Chairwoman BIGGERT. Thank you very much. My time has expired. The gentlewoman from New York, Ms. Maloney.

Mrs. MALONEY. Professor Scott, will you please send my regards to Larry Summers?

Mr. SCOTT. I will do so.

Mrs. MALONEY. We miss him. Okay.

You mentioned that the insurance industry in America may be affected somewhat by EU initiatives. Could you forward to the committee or speak about examples of certain initiatives that are impacting on the insurance business?

Mr. SCOTT. Yes. The EU has taken a European-wide initiative about regulation of insurance companies in general, and particularly with respect to capital adequacy. This is both at the level of insurance firms, as well as reinsurance firms. The question looming on the horizon is similar to the one that is raised by the conglomerates directive, which is well, if they are requiring all these kinds of controls on their own insurance firms, under what conditions are they going to allow American insurance firms to come into the EU. Are they going to require that there be some kind of equivalent regulation of insurance firms by us?

So I think those broad terms are the kind of issues that are going to be confronting the insurance industry in the near future, or are already confronting them.

Mrs. MALONEY. You mentioned how helpful you believe Secretary Snow's initiative of a special financial envoy to China is, which basically is the same idea of Mr. Thornburgh to have a special envoy in Brussels. Where else do you think we should have special envoys, ideally? We are in a world community and a world market, and the points that both of you raised are important.

Mr. SCOTT. I actually think this China initiative goes beyond what Mr. Thornburgh is suggesting.

Mrs. MALONEY. He was just Brussels.

Mr. SCOTT. But he is I think asking for a Treasury representative in the embassy in Brussels.

Mrs. MALONEY. Yes.

Mr. SCOTT. I think what we have done in China goes a step beyond that. The Secretary of the Treasury himself has an emissary from the Treasury Department there, not part of the State Department's operation in China, to give a direct link between Mr. Speltz who is his emissary and the Secretary with respect to ongoing negotiations with China on loosening up capital controls or preparing for more flexible exchange rates and things like that. I think that that signifies the special importance that the Treasury attaches to ongoing issues with China at the moment.

I think one could ask, what is more important in the big picture? Is Europe less important than China? Why should China have this kind of special status? I think that it is probably because China is in a more delicate stage. In our relationships with China, we are building a series of relationships there. We already have these relationships with the EU. I do not think I could recommend a proliferation of special emissaries.

Mrs. MALONEY. But you said a regional approach would be useful.

Mr. SCOTT. Right. I would support Mr. Thornburgh's idea for representation in the Brussels embassy of a Treasury attache.

Mr. THORNBURGH. May I make a comment?

Mrs. MALONEY. Sure.

Mr. THORNBURGH. We did meet with Under Secretary of Treasury Taylor at the Treasury. What we found out is that there are two budgets. This is classic. There is a budget for the permanent representatives which have gone down from 230 employees to 165, and then there is the budget for assistance slots which allow for special assistants in special countries, and that actually gets a little bit of the State Department foreign aid money. So what we may have is the classic problem of the pot going down on one side and going up on the other side, although it is still the same taxpayers's pool of dollars and perhaps we could be a little more efficient in how that money gets spent.

Mrs. MALONEY. You testified you felt that it was very important to the financial interests of America to have representations in Brussels and possibly other countries to be on the ground with the information. I am not going to suggest that.

I want to really ask you about capital. You testified, Mr. Thornburgh, that we are thriving very much on foreigners buying American securities and investing in America. I am concerned, we just 2 weeks ago, maybe it was 3 weeks ago, raised the debt ceiling an additional $2 trillion. The deficit now is galloping towards $600 billion or $500 billion, the numbers are huge. At what point do you think foreigners may decide they do not want to invest in America because of the huge debt that we have? We have always been in a stronger financial position than foreign countries, but now they may be concerned about our mounting debt.

Do you see that, any ramifications from that? Is that an issue or it is a non-issue? I am concerned about it for my grandchildren and my children, but I am also concerned about how far can we go in this direction before other countries may not want to invest in American securities and other investments. Are you hearing anything in your world community in which you interact with 35 countries every day, any concern about the growing debt of America for our financial strength?

Mr. THORNBURGH. That is a pretty loaded question. Luckily, I am not Alan Greenspan. I think the dollar will continue to be a reserve currency around the world. What we need to worry about, and the implication of your statement, which is a very serious question, is one about the cost of capital and about the value of the dollar. So the implications really come out to the strength of the dollar and what will the dollar buy 5 years from now versus what goods and services a dollar can buy today, and what will the cost of capital be for U.S. corporations and those corporations raising funds in dollars.

So I think the concerns that we would hear about the deficit really speak to the value of the dollar and the level of interest rates. I do not personally worry about the dollar losing its reserve currency status, although we should acknowledge that the EU now is the second-largest economy in the world, and a lot of us 10 years

ago did not think that countries would give up their local currency to exchange it for a common currency, and that of course has happened.

Mrs. MALONEY. Okay. My time has expired.

Chairwoman BIGGERT. Thank you.

Mr. Bachus?

Mr. BACHUS. Thank you.

Mr. Oldshue, I appreciate your endorsing this idea of a Treasury attache office in Brussels to advocate U.S. interests, and it may be that Congress needs to fund such an office. I think Mr. Thornburgh mentioned maybe relocating the attaches office in Frankfurt, which should not cost additional funds.

Let me ask this about the financial markets dialogue. There is a broad array of issues being discussed, but I ask all three of you gentlemen, are there other issues that ought to be included that are not? I will just start with Mr. Thornburgh and go down the line. Maybe also while you are answering that, any issues that should be included, what do you consider the most pressing issues?

Mr. THORNBURGH. I think for me the most pressing issue is making sure that the EU acknowledges U.S. GAAP as an equivalent accounting standard; two, that under the financial services conglomerate, that the SEC is acknowledged as an equivalent supervisor, because although Basel is not fully implemented until 2008, for capital regime purposes in the EU a new law comes into place in 2005, where equivalency of the home supervisor is very important. That impacts our U.S. securities firms doing business overseas.

An added issue that we would add to the list on the dialogue would be issues around the European clearance and settlement system. I think there have been recent articles that acknowledge that the cost of setting a securities transaction in Europe is roughly 97 cents and cross-border 35 cents, whereas in the U.S. that is 10 cents. So I think there are some inefficiencies in the European rules and regulations around clearance and settlement that do impact the cost of investing in the EU.

Mr. BACHUS. Okay. Mr. Oldshue?

Mr. OLDSHUE. I think I would reiterate the three issues that are our principal concerns. Certainly, the fair and consistent application of capital standards across foreign borders is one of three major issues for us. Secondly, and this goes beyond the financial industry, ensuring that convergence of accounting principles between Europe and the United States is managed in an intelligent, logical and useful way. Lastly, it is ensuring that the sometimes conflicting regulations governing the sharing of financial information, within our very different corporate structures in Europe and the U.S. are done in a way that is fair and consistent across borders. Those would be our three major issues.

Mr. BACHUS. Okay. Mr. Scott?

Mr. SCOTT. I think the issue of GAAP equivalence, as Mr. Thornburgh mentioned, is very important, but recognize that this is a two-way street. Unless the U.S. allows foreign firms to come in here, especially European firms under IAS. It seems to me unlikely the Europeans are going to allow our firms in the future to go in there under U.S. GAAP. This is an issue that is right around the corner. It is coming up in 2005. As I have testified, I do not

think that this point, and this is the most important issue between U.S. and Europe today, and it has not been resolved by this dialogue and needs to be resolved. I think anything Congress can do to help this get resolved would be a good idea.

In terms of adding things to the process, my testimony has focused on the fact that we need to be more proactive and not just react against particular problems. I would set the dialogue's agenda to create a trans-Atlantic market in financial services. When you look at it in that respect, you are not just fighting problems. You are saying what needs to be done in order to make this happen.

For instance, I think if you look at that as an objective, you start focusing on common rules for the distribution of securities on both sides of the border, which is not really an active point today in the dialogue. Accounting standards are, but beyond accounting standards, just general questions of what elements of disclosure must be made in a prospectus; how securities need to be distributed; how we enforce our rules with respect to distribution of securities.

All these issues would come up if one had an objective of establishing a trans-Atlantic market in financial services.

Mr. BACHUS. Can I have one follow-up question? You have all mentioned accounting standards, international accounting standards. Within that is a single set of international accounting standards. That brings to mind the IASB 39, Italy, Spain, France, and Belgium have all objected to. I would be interested in hearing from you about their reported objections to IASB 39. I think that is right.

Mr. SCOTT. We had quite a to-do when we were dealing with the same kind of issue in the U.S. In fact, many of our banks had problems with this. Indeed the Chairman of the Federal Reserve was not sure that he liked the idea of constantly marking the securities of financial institutions because it introduced volatility. So in a sense, it is no surprise that this same issue is being actively debated there.

It may turn out that they do not accept IAS 39. I think if that occurs, that does not mean the end of IAS in the U.S., even though that would be a key missing part. I think what the U.S. could then do is say, okay, you can come in here under IAS, but you have to put in a 39 as well. That is, if we have some important differences between IAS and U.S. GAAP in 2005, I do not think we need to say, oh, we cannot have IAS. We can have IAS with some additions or some modifications. I think we need to start thinking in that direction.

Mr. BACHUS. Okay. Mr. Thornburgh, would you like to comment on the IASB 39 and some of the Europeans' objections to that?

Mr. THORNBURGH. Fortunately, Congressman Bachus, I might be viewed as the fool at Credit Suisse who moved Credit Suisse to U.S. GAAP. I started that project when I was the CFO in 1998. It took us until 2003 to actually be able to move from Swiss accounting standards to U.S. GAAP. It cost us over $150 million to do it. When we got there, we had to deal with FAS 133, which is the equivalent to IASB 39.

I must say this is a quite problematic issue. It is very costly for firms to reconcile to a different accounting standard. It is very ex-

pensive to convert accounting standards, especially in the financial services industry. FAS 133 is actually more restrictive than IASB 39. We are, and I think most of us in the financial services industry today, dealing with the type of volatility issues that the Europeans are concerned about. But IAS 39 actually allows for more lenient accounting to take some of that volatility out. So I think it is a very serious issue. If there is too much of a gap between the two of them, we may not be able to achieve the professor's goals, which I think are the right goals.

The last thing I would say is, then you go to Basel II. If you have a number of internationally active European banks using one accounting standard for treating derivatives, and U.S. banks using another accounting standard, we will have an unlevel playing field as it relates to the application of market risk capital under Basel II, and we will have an unlevel playing field as it relates to the ability of firms to compete around the globe. Frankly, I am not too sure the investors in securities really can tell you the difference between the two accounting standards and would make an investment decision based on the difference in the accounting standards.

So anything that Congress could do to knock these two folks together to agree on acknowledging equivalency of accounting standards, it is hugely important to the capital markets.

Mr. BACHUS. If these objections block the adoption of a single set of accounting standards, how critical is that to impeding or blocking this trans-Atlantic market that we are talking about?

Mr. THORNBURGH. I think it is absolutely fundamental to the functioning of these markets. It is the underlying data and information on which financial markets depend. I do not think there could be anything more important to trans-Atlantic financial markets than common accounting rules.

Mr. OLDSHUE. I concur. I think they do not necessarily have to be the same in every aspect, and there may well be costs of convergence that are not worth the trouble in some of its details, but I think the general theme here is entirely correct.

Mr. BACHUS. But a single set that may allow for some differences. Mr. Thornburgh, do you agree?

Mr. THORNBURGH. I think it is usually important to companies like GE Capital, Ford Motor Credit, General Motors Credit, banks, the agencies. If they have to reconcile or adapt to IAS to have access to the European pool of capital, that could be very restrictive because it will take a while to make that conversion which I talked about. In the interim period of time, our corporations will not have access to a huge pool of capital around the world.

Mr. BACHUS. All right. Thank you.

Chairwoman BIGGERT. Thank you very much, Mr. Bachus, for those questions. I think we are just about out of questions, but I have just one quick question. That is, should the Office of the U.S. Trade Representative be involved in the US-EU regulatory dialogue? If not, why not? And if yes, why? I guess that would be the alternative.

Professor Scott?

Mr. SCOTT. I will take a stab. I think traditionally we have not put financial regulatory issues into the WTO. I think that the reason for this is a good one. Certainly, WTO has dealt with financial

issues, insofar as they have been access issues, access to foreign markets. But with respect to regulation, it has been left out. There is a so-called prudential carve-out in fact, it is called a prudential carve-out from WTO.

I think this is a good idea that regulation be separate. I think financial issues are different from trade issues. Certainly, the agencies in the United States that have responsibility for this are different from the parts of the government that have responsibility for trade. So I think that it would not be good to try to fold this into WTO.

WTO also has, as I know you are aware, a large panoply of processes, formal processes that take place with respect to resolving disputes, panels, issues. It is a very legalistic, kind of setup. Perhaps I should be in favor of that as a law professor, but I really am not for financial issues because I think financial issues tend to be not quite so legalistic; tend to deal with more general policy issues. So I think we have it right that the USTR should not be dealing with these kinds of issues.

Chairwoman BIGGERT. Anyone else? Okay.

Is there anything else that you think we left out that you would like to comment on?

Mr. OLDSHUE. I do not think so. We really appreciate the opportunity to speak with you today. It has been good for us.

Chairwoman BIGGERT. We really appreciate your being here. The expertise that you all have has been most, most helpful and I hope that you will be back again sometime. We really appreciate it.

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

With that, this hearing is adjourned.

[Whereupon, at 11:23 a.m., the subcommittee was adjourned.]

A P P E N D I X

June 17, 2004

Prepared, not delivered
Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Domestic and International Monetary Policy, Trade and Technology

"The U.S.-E.U. Regulatory Dialogue: The Private Sector Perspective"
June 17, 2004

Good morning. Today the Financial Services Committee continues its inquiry into the regulatory dialogue between the United States and the European Union. I had the pleasure of chairing the first hearing on the issue last month, in which government officials from the United States and the European Commission testified. I am particularly pleased that the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology is following up with a hearing to explore the private sector perspectives on this dialogue and I thank Vice Chairman Judy Biggert for chairing today's hearing.

No one disputes the importance and value of growing financial market integration across the Atlantic. A recent study by the Center for Transatlantic Relations quantifies the level of deep integration between the United States and Europe. I was struck by the value of sales of U.S. affiliates of European companies to Europe and European affiliates of U.S. companies to the U.S. This figure far outstrips the value of actual exports between the U.S. and Europe.

We must work more closely together. Differences in philosophy regarding the role of government in the private markets as well as different policy priorities can create tensions and can increase compliance costs for financial firms.

Last month, we heard testimony from regulators on both sides of the Atlantic indicating that the dialogue among the European Commission, the U.S. Treasury Department, the Federal Reserve, and the Securities and Exchange Commission provides a valuable forum to prevent misunderstandings and to find potential solutions for conflicts in regulatory standards. We also heard testimony from one self-regulatory organization (the Public Company Accounting Oversight Board) concerning its new system for engaging in dialogue and balancing supervisory objectives in the oversight of foreign firms. We also heard from the SEC about a new form of strategic engagement with European partners through the EU's Committee of European Securities Regulators.

My conclusion is that the regulatory dialogue between the US and the EU actually takes many forms and regulators on both sides of the Atlantic are being creative in finding ways to work together.

Convergence and equivalence in regulatory structures can only make sense when such trends are already underway in markets and where differences in regulation can have a detrimental impact. So I am glad that representatives from two major U.S. trade associations representing the banking and securities industries and a leading academic can today provide views on the U.S.-E.U. Regulatory Dialogue.

I look forward to the testimony today. Our institutional arrangements are currently in flux as we adjust to a more global business environment. While it is unrealistic to assume that differences in regulatory standards will disappear in the near future, it is necessary and appropriate for us to identify clearly where differences may be necessary and where they might reasonably diminish without harming the integrity of domestic and international markets.

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U.S.-EU FINANCIAL MARKETS DIALOGUE

Testimony of
Paul F. Oldshue, Executive Vice President & Manager
International Banking Group, U.S. Bancorp
on behalf of the
Bankers' Association for Finance and Trade

Before the House Financial Services Committee's
Subcommittee on Domestic and International Monetary Policy,
Trade and Technology
June 17, 2004

Introduction

I am pleased to be with you today to discuss the banking industry's views regarding the Financial Markets Dialogue between the United States and the European Union. Regulation of financial products and services imposes additional costs on financial firms and ultimately affects their customers' cost of capital. Unnecessary regulatory conflict, inconsistency, and duplication can only add to those costs and those of us in the financial services business strongly support the efforts of U.S. and EU officials to limit regulatory disfunction. We are grateful for this hearing and the full committee's earlier hearing on May 13th to examine this important subject.

I am testifying today as the immediate past president of BAFT—the Bankers' Association for Finance and Trade—an organization founded in 1921 by bankers from Buffalo, Cleveland, and Detroit to enable its members to "interchange opinions [regarding] the conduct of foreign business", "to urge the passage of wise and useful legislation", "to oppose the enactment of prejudicial laws," and "to aid the development

and maintenance of foreign trade." That mission, set out almost 83 years ago, seems particularly apt for the subject of today's hearing.

Today BAFT is an affiliate of the American Bankers Association. Its membership includes most of the major American banks that are active in international banking and also many of the major international banks chartered outside this country. My employer, Minneapolis-based U.S. Bancorp, is the 7th largest financial services holding company in the United States, with assets of $192 billion. Our principal bank subsidiary, U.S. Bank, has 2,275 retail banking offices and 10.6 million clients in 24 states throughout the Midwest and West. We focus internationally on providing trade and payment processing services to our domestic clients, and in that connection we maintain correspondent relationships with more than 2,000 banks in 125 countries.

Statistics on Trade and Investment Demonstrate the Importance of the U.S.-EU Relationship

The close economic relationship between the United States and the European Union can be demonstrated with just a few statistics. Transatlantic commerce is about 60 percent of the world's total trade and investment.[1] If you exclude Canada and Mexico because of their close proximity to the United States, five of our top ten trading partners are in the European Union.[2] More than 52% of the EU's foreign direct investment from 1998 to 2001 went into the U.S. and more than 61% of the foreign direct investment that went

[1] *Source: U.S. Department of Commerce, International Trade Administration.*
[2] Germany, U.K., France, Ireland, and Italy. *Source: U.S. Census Bureau, Foreign Trade Statistics Year-to-Date March 2004 at www.census.gov/foreign-trade/statistics/country/top/top0403.html.*

into the EU during the same period came from the U.S.[3] The total amount of two-way investment between the EU and the U.S. totals over $1.2 trillion.[4] It is clear that we have an important common economic interest; close cooperation to advance that interest should be good for both of us.

But that's easier said than done. The U.S. and the EU have different cultural, political, and economic structures and, consequently, many differences in the ways that we approach the conduct of business and the ways that we regulate it. These differences have long been recognized and over the years the U.S. and its economic partners in Europe have engaged in numerous efforts to accommodate our differences, including the 1990 Transatlantic Declaration on E.C.-U.S. Relations, 1995 Transatlantic Business Dialogue, 1998 U.S.-E.C. Mutual Recognition Agreements, 1998 Transatlantic Economic Partnership, and the 2002 U.S.-EU Guidelines for Regulatory Cooperation and Transparency. The current U.S.-EU Financial Markets Dialogue is the most recent of these efforts to build a closer, more cooperative economic relationship.

What the U.S.-EU Financial Markets Dialogue Has Accomplished and Some Suggestions of How it Could Be Improved

There is no doubt that the U.S.-EU Financial Markets Dialogue has been a constructive exercise and that it has accomplished a great deal simply by establishing new lines of communication. Since the Dialogue began in March 2002, U.S. government and EU officials have discussed numerous issues and developed approaches that likely will avoid several potentially serious problems. The discussions have included the EU's Financial

[3] *Source: European Union statistics on bilateral trade relations at www.europa.eu.int/comm/trade/issues/bilateral/countries/usa/index_en.htm*
[4] *Ibid.*

Conglomerates Directive, and it appears likely that U.S. financial firms generally will be considered to have consolidated supervision equivalent to that called for by the Directive. In discussions of the EU's Prospectus and Transparency Directives the case was made for finding U.S. GAAP to be equivalent to International Accounting Standards (IAS), and the exchange of views supported a decision to include a grandfather provision for currently outstanding issues of fixed income securities (bonds). Discussions of the Investment Services Directive led to modifications that will allow the U.S. practice of internal order matching and price improvement in many transactions, and discussions of the Takeover Directive have brought EU assurances that non-EU firms will not be discriminated against.

We think this is a good start and we believe that the value of the Dialogue will increase as it continues and as relationships deepen and issues are added. But more can be done and we think that the Dialogue can be improved in several respects.

As it now stands, the Dialogue is conducted between U.S. government officials (from the Treasury Department, the Federal Reserve, and the Securities and Exchange Commission) and officials of the European Commission. While it is not being conducted under a shroud of secrecy, the Dialogue process is not completely transparent either. I think it is safe to say that many American bankers really do not know much about the Dialogue, including what is being discussed and who is discussing it. (This is a concern that is shared by at least some of our colleagues in Europe as well.) It would be a big improvement if the U.S. participants made a greater effort to consult with U.S. banks, securities firms, and other financial firms early in the process and on an on-going basis.

This would give us a chance to provide our views as to what should be on the agenda and what the priorities should be, and also to inform the participants about market realities and other practical details that are best known to those of us doing business in the international arena every day.

The breadth of Dialogue participation is expanding in some respects, but we think that more can be done in that regard as well. In testimony before the House Financial Services Committee on May 13, 2004, both Ethiopis Tafara, the SEC's Director of International Affairs, and Alexander Schaub, Director-General, DG Internal Market of the European Commission, referred to steps being taken toward greater consultation and cooperation between the SEC and the Committee of European Securities Regulators (CESR). This is great and we hope that similar working relationships will develop among the other financial regulators in the U.S. and EU.

Carrying this one step further, we also believe that the Dialogue should include Members of Congress and staff, particularly those who are on this Committee. It is not only the Treasury Department, the Fed and the SEC that deal with issues regarding the regulation of financial services and thus have a need to communicate and coordinate with policymakers in the EU. We think much could be gained if Members of Congress and their staffs engaged in a *continuing* Dialogue with appropriate officials in the EU, again with input from the private sector.

We think that the concept of "intelligent work sharing" advocated by Alexander Schaub could have useful application in both the regulatory and legislative spheres. The more effort put into anticipating and avoiding problems and sharing best practices when the

rules are first written, the less need there will be for difficult problem solving when they are applied. Among other things, we think the Congress and regulatory and other government agencies should consider a staff exchange program, in which staff with expertise in these areas are seconded overseas to work with their counterparts in the other governing body to share their own knowledge and experience and gain the benefits of others'.

In that regard, we also would like to recommend that the U.S. Treasury Department consider putting more of its people on the ground in Europe. As we understand it, the Treasury Department only has one person stationed in Europe, at the U.S. embassy in Frankfurt. In my experience there is nothing like local knowledge in order to anticipate, understand and react to new developments in particular markets. Treasury should seriously consider adding staff in various locations in Europe, particularly Brussels.

Banking Industry Issues

I would like to comment on several specific issues that concern the banking industry and that are or should be on the Dialogue's agenda.

Implementation of Basel II

The Basel Committee (which includes representatives from the U.S. and the EU) is on the verge of finalizing new bank capital standards, set out in the Basel II Capital Accord. Bankers have several concerns. One is that the U.S. plans to continue using the leverage and well-capitalized requirements as additional capital standards for U.S. banks. These will effectively act as floors for any capital relief created by Basel II. Since there is no

foreign equivalent, U.S. banks could be required to hold more capital than their foreign competitors, increasing their costs and making them less competitive.

Bankers also are concerned that there could be significant differences in the application of Basel II from country to country, and that these differences could impede banking across national borders. To address these concerns, we recommend that the U.S.-EU Financial Markets Dialogue include a discussion of how to coordinate the application of the new capital standards and that the following approaches be considered:

- adopt the principle of lead supervision by the home-country regulator,
- share supervisory information,
- clearly communicate the supervisory principles for capital adequacy, and
- take steps to limit the differences in application of Basel II from country to country.

Our main concern is that banks could be excluded from overseas markets by inconsistent interpretations of Basel II. The Accord gives individual national regulators considerable discretion over how the rules will be applied, particularly with regard to the operational risk-based capital charge and with regard to supervisory standards (Pillar II). Regulators in the U.S., EU and elsewhere are in the process of developing the rules that will implement Basel II in their respective countries. Each has the authority to require all banks, domestic and foreign, that want to do business in its country to abide by its own interpretations. If banks have to satisfy different requirements in each country in which they operate, then individual institutions might have to limit the scope of their

international operations. The result would be less competition in international markets, clearly an undesirable outcome.

One solution would be to adopt the principle of lead supervision, giving the regulator from a bank's home country the responsibility to certify capital compliance for the bank globally. In a May 12, 2004 release, the Basel Committee proposed that host-country regulators should accept capital approval and validation from a foreign bank's home country regulator, reducing the implementation burden on banks and conserving supervisory resources.

What will it take for a regulator to accept that a foreign bank operating in its markets will be subject only to home country capital supervision? The Basel Committee proposes that home and host country regulators coordinate and cooperate in supervising shared institutions. This would be an appropriate topic for discussion by the U.S. and EU in the context of the Financial Markets Dialogue.

To the extent application of the rules differs from country to country, regulators also should take steps to help multinational banks understand local discretionary differences in capital supervision. Basel II—especially the advanced approaches—is immensely complex. Regulators can help banks comply with their rules by providing as much detail as possible as to how they will examine banks for compliance. U.S. and EU regulators should explain the respective rules of home and host country supervision, as well as the exercise of discretion allowed under the Accord.

The best solution, however, would be for the U.S. and EU to work together to limit the use of national discretion under Basel II. This would promote both full and fair competition in financial services and a sound global financial system. As the homes of most of the world's major banks, the U.S. and EU should use the next three years before the Accord is implemented to harmonize their countries' approaches to application of the capital requirements.

Convergence in International Accounting Standards

The reliability of financial information reported by public and private companies is fundamental to sound economic growth and international trade and investment. For that reason, we believe it is appropriate that the U.S.-EU Financial Markets Dialogue include a discussion of accounting standards. BAFT supports the efforts of the International Accounting Standards Board (IASB) to harmonize international accounting standards, but we believe there are aspects of the IASB and its work that should be discussed by U.S. and EU officials. We recommend the Dialogue focus on three particular issues:

- transparency in the rulemaking process,
- principles-based accounting, and
- the costs and benefits of convergence of existing accounting rules.

The accounting rulemaking process should be more open. Active participation by industry experts in the development and interpretation of new rules will lead to better rules. In order to make the process more open, we recommend that IASB should do the following:

- hold periodic meetings with the private sector to provide information about IASB's activities,
- form industry working groups that can provide information about complex transactions, processes and procedures relating to potential accounting rule changes,
- host more roundtable discussions to allow interested parties the opportunity to discuss concerns with the IASB; make these as open as possible, rather than exclusive sessions on an invitation-only basis,
- hold additional meetings with experts on issue-specific IASB projects or industry-specific issues,
- use field tests, something not previously considered by the IASB, to ensure that rules can be implemented, and
- improve public access to the IASB process by (a) posting all comment letters on the IASB website, and (b) making Board meetings and other meetings available as a webcast or by providing telephone access for constituents that cannot attend London meetings in person.

Many of IASB's proposals have been issued with very short comment deadlines. We are concerned that these time limits make it difficult to provide quality responses and thus limit the value of comments to rulemakers. It also is important that companies be given adequate time to understand and implement new rules.

Improvements also should be made in the process of appointing rulemakers. Members of the IASB are appointed by the Board of Trustees of the IASB Foundation. Both the

process by which individuals are elected to the Board of Trustees and the process by which the trustees identify and select candidates to serve on the IASB Board should be made more transparent. The selection of candidates, credentials of candidates, interview process, and decision-making process associated with selection of both the trustees and the IASB Board members should be open and disclosed to the public.

The IASB has decided that future rules will be written using a principles-based approach. This could present preparers, auditors, accountants, and rulemakers with significant problems if the rules are too general. We believe that a balanced approach is needed; there must be a sufficient level of detail to make consistent application of a rule likely. Otherwise, companies will be faced with a large number of subsequent interpretations, possibly resulting in expensive changes to systems and procedures. Moreover, without sufficient detail, much of the implementation guidance will be provided by individual accountants, accounting firms, or securities regulators, and their individual interpretations will likely result in varying applications of the rules. We recommend that the Dialogue include a discussion of the appropriate level of detail in new rules to encourage consistent application of International Accounting Standards.

Efforts are being made to bring about convergence in U.S. and IASB accounting rules. In many cases, both accounting methods are acceptable, and the rulemakers simply choose one rule over another. Accounting rulemakers have indicated that they expect many of these changes to be relatively minor, but relatively minor accounting changes can be costly to implement. We are concerned that the cost to make these changes in many

cases will outweigh the benefit and thus we recommend that the Dialogue include a discussion of how much convergence is really needed.

Privacy and Data Protection

Another important issue that should be considered in connection with the Financial Markets Dialogue is the impact of the European Union's Directive on Data Protection on U.S. banks and other financial institutions doing business in the EU.

The Directive, which was adopted in October 1998, sets forth the rights that individuals have over their personal financial information and the standards that companies must follow when collecting, using, sharing or selling that information. In November 2000, after two years of discussion, the United States and the EU completed negotiations on a safe harbor under which U.S. companies could voluntarily certify that they meet specified privacy standards. While the safe harbor covers all industry sectors, including financial services, it does not cover personal financial information. The EU's position then was that more time was needed to examine the privacy provisions in the Gramm-Leach-Bliley Act. Provisions of the Fair Credit Reporting Act also were viewed as a stumbling block at that time.

Since 2000 the EU informally has committed to postponing enforcement of the Directive with respect to the financial services sector, pending the outcome of U.S. and EU negotiations. This standstill agreement expired on July 1, 2001, leaving U.S. banks and other financial services companies vulnerable to action by government authorities in EU countries. In fact, the directive also might create private rights of action, increasing the potential legal liability of U.S. firms.

One of the reasons that European countries are reluctant to accept U.S. privacy laws is that the U.S. allows financial services companies to share personal financial information among affiliates. This is necessary because financial institutions in the U.S. generally have a corporate structure that is quite different from that used in Europe. In the U.S., financial organizations offering a broad array of financial services utilize multiple corporate entities (*e.g.*, a bank, securities firm, or insurance company) affiliated with each other through common ownership under a holding company. The companies share information across the organization in order to offer and provide consumers a wide variety of customized financial services. In Europe, financial services are more likely to be delivered through a single company, a universal bank, which eliminates the need to share information among affiliates. Because of these differences in organizational structure, restrictions on information sharing between affiliates could well give an unfair competitive advantage to European firms.

The European Union is an important market for U.S. financial services companies. Thus we are eager for the EU to acknowledge that the Gramm-Leach-Bliley Act and other financial privacy laws, such as the recently enacted Fair and Accurate Credit Transactions Act, provide adequate privacy protection for personal financial information. We urge the Treasury Department and other participants in the Dialogue to make this an important item on their agenda.

Other Issues for Discussion

There are numerous other issues that concern U.S. banks and other financial institutions that might be appropriate for discussion in the context of the Financial Markets Dialogue.

For example, U.S. banks want to ensure that the information gathering obligations imposed on them under the USA Patriot Act are not more intrusive and burdensome on their customers than the duties imposed on banks in the EU. This could create a competitive disadvantage for U.S. banks and they feel that their interests would be served by a discussion of ways to ensure consistency among major financial markets wherever located. This would also serve the interests of the international law enforcement community because an anti-money laundering system that lacks substantial uniformity from country to country is bound to fail.

U.S. banks also are concerned about efforts by tax officials both in the U.S. and the EU to impose reporting obligations on banks that hold deposits of nonresident aliens. In addition to policy issues that should be discussed up front, such as the likelihood of deposits being shifted to countries that are not participating or that maintain high levels of privacy protection, these efforts undoubtedly will give rise to technical compliance issues that should be the subject of consideration and discussion that includes some level of participation by the private sector on which the compliance burden will fall.

There also are issues regarding cross-border securities business that concern U.S. banks that have securities affiliates, and we generally share the views expressed in the testimony of the Securities Industry Association. Among other things, banks and other financial firms are concerned about their ability to meet customer needs across national borders. This includes their ability to continue serving customers that move to another country and also their customers' ability to make investments in foreign countries. The SEC and European securities regulators should discuss these issues with the overriding

objective of giving investors the greatest possible investment opportunities and flexibility, without compromising standards of investor protection. Mutual recognition of regulatory systems that provide comparable levels of investor protection would seem to be the right approach.

Differences in insurance regulation might not readily be resolved in the Financial Markets Dialogue, but they deserve mention because they have important international ramifications. Some outside of the U.S. argue that our system of state-level insurance regulation constitutes a trade barrier because foreign insurance companies cannot sell insurance throughout the U.S. unless they get a license in each state. (Of course domestic U.S. insurance companies are treated the same—they also have to get a license in each state where they sell insurance—so it would seem the U.S. approach is one of national treatment which ordinarily is unobjectionable.) By way of contrast, U.S. insurance companies generally can qualify to sell insurance throughout the EU on the basis of a single license. The Dialogue cannot do much to address this difference in approach because changing the structure of insurance regulation in the U.S. would require federal legislation.

House Financial Services Committee Chairman Mike Oxley and Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee Chairman Richard Baker have developed a plan to standardize certain aspects of state insurance regulation. BAFT's insurance affiliate, the American Bankers Insurance Association (ABIA), supports the Oxley-Baker plan and believes it is an important step in modernizing domestic insurance regulation. But ABIA and other financial trade associations think

Congress should consider whether to go further and create an optional federal insurance charter. We respectfully suggest that the Financial Services Committee hold additional hearings in the future to examine the international ramifications of insurance regulation in the U.S.

Summary

BAFT strongly supports the U.S.-EU Financial Markets Dialogue. It has accomplished much, both in fostering a healthy climate of trust and openness and in exploring particular issues that either have been or are likely to be resolved in a mutually satisfactory manner. Notwithstanding this very promising beginning, however, we also believe that the Dialogue could be improved in several respects. We urge the U.S. participants to do more to reach out and consult with firms in the private sector. We also believe that the Dialogue could be enhanced by expansion. It should include discussions among regulators, and also discussions among Members of Congress, their staffs, and counterparts in the EU. The Treasury Department should consider enhancing its own resources by adding staff in key European financial capitals.

The specific issues that concern U.S. banks operating in Europe include implementation of Basel II, convergence among different national and multinational accounting standards, and privacy and data protection measures. U.S. banks also are concerned about competitive disparities that could arise out of U.S. anti-money laundering requirements, new tax reporting obligations, steps that can be taken to enhance cross-border securities business, and the international implications of insurance regulation in the U.S.

We are very encouraged by the progress that has been made so far, and we are enthusiastic about the potential the future holds. Thank you very much for holding this hearing and allowing us to participate.

Statement of

Kenneth W. Dam, Max Pam Professor of Law , University of Chicago Law School and Senior Fellow at the Brookings Institution

and

Hal S. Scott, Nomura Professor of International Financial Systems, Harvard Law School

on the U.S.-E.U. Financial Markets Dialogue

Before the Committee on Financial Services,
U.S. House of Representatives
June 17, 2004

Chairman Oxley, Ranking Member Frank, and distinguished members of the Committee. Thank you for permitting me to testify today on matters relating to the informal U.S.-E.U. Financial Markets Regulatory Dialogue. I am the Nomura Professor of International Financial Systems at Harvard Law School. I will be reading a statement prepared by myself and Kenneth Dam, the Max Pam Professor of Law at the University of Chicago Law School and Senior Fellow at the Brookings Institution, and formerly Deputy Secretary of the Treasury.

Our testimony begins with an assessment of the effectiveness of the Dialogue. While the Dialogue has made a significant contribution to better relations with the E.U., it has failed to resolve the most important issue confronting the two markets, whether or not the U.S., like the E.U., will accept international accounting standards. We also believe the Dialogue should be more proactive in removing obstacles to the development of an efficient Trans-Atlantic Market in Financial Services; its role should not be limited to fire fighting. Finally, we believe that the Dialogue needs to include additional government participants and to become more transparent.

Many of the ideas in this testimony are based on Statement No. 203 of the Shadow Financial Regulatory Committee of February 9, 2004, entitled "Toward a Single Trans-Atlantic Market in Financial Services," a copy of which is appended to this statement.

Effectiveness

The Dialogue process began in March 2002, and now takes place on more or less a quarterly basis. On the U.S. side, the Treasury has taken the lead with the Federal Reserve and the Securities and Exchange Commission (SEC) also participating. The E.U. Commission is the sole interlocutor for the E.U. Commissioner Bolkestein and Alexander Schaub, Director-

General for the Internal Market and Financial Services, have been the key E.U. participants.

The most successful result of the Dialogue has been to temper the application of Sarbanes-Oxley to foreign firms, some of which had great difficulty in simultaneously complying with the new Act and their own laws. The SEC sought to accommodate these firms by adopting a flexible approach to the Act's requirements. For example, countries like Germany requires half of its supervisory board, which oversees the auditors), to be composed of labor representatives. The SEC allowed German companies to meet the Sarbanes-Oxley auditor independence requirements, even though such employees would not be considered independent in the U.S. In fact, it was the SEC itself, working with the E.U., member states and E.U. firms, which implemented these changes. The Dialogue had no formal role in the regulatory process. However, we believe the presence of the Treasury's broad perspective on U.S.-E.U. relations and its deep concern with the health and efficiency of capital markets, may have contributed to the willingness of the SEC to react sympathetically to E.U. concerns. Absent more formal regulatory consolidation in the U.S., the Dialogue serves a useful purpose in coordinating U.S. policy. In this sense, the Dialogue is as much an internal process among U.S. regulators as it is an external process with the E.U.

The Dialogue has also played an important role in addressing issues created by the E.U's proposed Financial Conglomerates Directive. This proposal would subject U.S. holding companies with operations in the E.U. to E.U. regulation unless these holding companies were subject to "equivalent" U.S. regulation. Conglomerates by their very nature cut across different financial activities–banking, securities and insurance. Both the Federal Reserve and the SEC had a direct concern about whether their own holding company regulations (newly adopted in the

case of the SEC) met the equivalence test. It is very useful for different functional U.S. regulators to discuss these issues among themselves, as well as with the E.U.

We believe the Dialogue has been less important in dealing with issues addressed in international fora, like issues arising out of the new generation of bank capital standards (Basel II) formulated by the Basel Committee on Banking Supervision. The U.S. through the Federal Reserve and the Treasury's Office of the Comptroller of the Currency, has had full participation in the formulation of these standards. The U.S. has decided to implement Basel II only for the most sophisticated and international U.S. banks, even though the E.U. plans to apply Basel II to all of its banks. While this has generated some tension between the U.S. and E.U. representatives on the Basel Committee, it is unlikely that the Dialogue can do much to change the outcome already agreed to by the Treasury and the Reserve Board.

The most noteworthy shortcoming of the Dialogue is its failure to resolve a potential crisis that may be precipitated by the E.U.'s anticipated adoption of international accounting standards (IAS) in 2005. Currently, under SEC regulations, foreign firms may only issue securities or have their securities traded in the U.S. public markets if such firms either state their accounts in or reconcile their accounts to U.S. GAAP. Absent a change in SEC policy, E.U. firms which state their accounts in IAS will be unable to access the U.S. public market. This could lead the E.U. to take the position that U.S. firms could no longer use U.S. GAAP in the E.U. market. This could have a severe effect on U.S. firms issuing capital abroad and further increase the segmentation between the U.S. and E.U markets. This is an important issue that must be resolved.

This is not the occasion for a full examination of whether the SEC should permit foreign

firms to use IAS. Suffice it to say that we believe it should because: (1) there is no evidence that U.S. GAAP is a better accounting standard than IAS; (2) IAS are by definition international, administered by an organization that the U.S. took a significant role in creating and consisting of standards that U.S. helped formulate; (3) IAS and U.S. GAAP are not that far apart, and the FASB-IASB Convergence Project has reduced the differences; (4) maintaining the requirement for U.S. GAAP in the U.S. does not necessarily increase investor protection since U.S. investors are forced to buy foreign securities abroad in less regulated markets; and (5) U.S. public trading venues will lose important sources of revenue as a result of the fact that the trading of unregistered foreign securities will only take place abroad.

In the case of Sarbanes-Oxley, the U.S. Treasury may well have served to broaden the SEC's perspective. In the case of accounting standards, it is not even clear what the Treasury's perspective is. If the Treasury favors permitting IAS in the U.S. it has yet to persuade the SEC. The year 2005 is just around the corner. This is an issue to which this Committee needs to give special attention.

A Broader Initiative

As the Shadow Financial Regulatory Committee stated in February, we believe the Dialogue should be broadened beyond solving particular problems, to embracing the positive agenda of creating a single Trans-Atlantic Market in Financial Services. The goal of this effort would be to remove barriers to cross-border transactions, particularly in capital markets where significant barriers remain.

The Trans-Atlantic Market in Financial Services is currently divided by different disclosure rules, not only with respect to accounting standards. While U.S. and E.U. adoption of

basic disclosure rules of the International Organization of Securities Commissioners (IOSCO) have helped breach the gap, significant differences remain with respect to complicated disclosure issues like management predictions, or what securities lawyers call forward-looking statements. The difference between E.U. and U.S. disclosure requirements is further complicated by the multiplicity of disclosure rules within the E.U. Under existing law, the E.U. allows an issuer to issue its securities throughout the E.U. under the disclosure rules of its home country–the single passport system. The E.U. is now rejecting this approach because it did not work–only Deutsche Telecom has used the home-country system to make a pan-E.U. securities offering. The single passport system failed to work because, in fact, host countries were still permitted to impose additional disclosure requirements to meet the particular needs of their investors, e.g. tax effect of the offering, and because of the need to translate offering documents into the language of each host country. The E.U. is now in the process of adopting a Common Prospectus and a common approach to continuous disclosure through two new Directives. Further, it has created a new body, the Committee of European Securities Regulators (CESR) to facilitate these efforts. The SEC should start working with the CESR to harmonize disclosure rules so that the two sides could develop a common Trans-Atlantic prospectus and ongoing disclosure rules.

There is also much to be done in creating common distribution rules, with respect to matters like the use of research reports during public offerings and requirements for the delivery of prospectuses. One should also look at the new initiatives in the U.S. and E.U. on market structure. Given the increasing internationalization of the trading in securities markets, we should be looking at market structure from an international perspective. There is also need for further thinking on ways to resolve enforcement differences between the two sides of the

Atlantic. A joint SEC-CESR committee could also work on these matters. We commend the SEC for beginning to take steps in meeting with CESR but much more needs to be done.

Principles

In our view, an effective Trans-Atlantic Market in Financial Services would be best achieved through common regulatory rules and enforcement throughout the U.S. and E.U. While this might forestall regulatory competition, which can restrain regulatory excess and lead to innovation, these theoretical benefits are more than outweighed by the cost savings and efficiencies achievable by common rules. The two sides of the Atlantic can still compete over ideas for what common rules we should have, and how they should be changed over time. Common rules will take time to achieve but we must make this a priority and start serious efforts at convergence now.

We do not believe the "equivalence" alternative offered by the E.U. is workable for rules pertaining to the offering of securities.. The equivalence approach would require the U.S. to allow E.U. firms to offer securities in the U.S. under E.U. rules (which include the rules of various member states as well as the E.U.'s own rules). As we have pointed out, this home country approach for securities offerings has not even worked within the E.U. , and is in the process of being replaced by harmonized rules in the form of the Common Prospectus.

There is a place for the equivalence principle, but it is in the regulation of firms and not transactions like securities offerings. The U.S. currently uses a type of equivalence test with respect to the operation of U.S. branches of foreign banks in the U.S. We permit a foreign bank to establish and operate a branch in the U.S. if the bank is subject to "effective" consolidated supervision in its home country, even though such supervision may be different in content and

approach to our own. The Federal Reserve has developed a methodology to assess the effectiveness of foreign supervision. Similarly, an equivalence test has been used for holding company regulation, as under the E.U. Financial Conglomerates Directive. We further note that the Public Company Accounting Oversight Board (PCAOB) will permit a foreign audit firm to rely on its home country inspection, without the need for additional U.S. inspection, depending on the independence and rigor of the home inspection. Again, the foreign regulatory approach need not be identical; it must be equivalent in the sense of meeting U.S. standards.

The equivalence test as applied to regulation of firms is workable because there are ways to measure whether the foreign regulatory approach is equivalent. Regulation of firms is principally aimed at insuring their safety and soundness and avoiding their failure. One can measure failure rates. In the case of audit firms one can make an assessment as to whether the foreign inspectors have a means to determine whether the auditors they inspect are independent and rigorous.

Transaction requirements pertain to the rules for offering securities, whether they relate to disclosure, methods of distribution or enforcement. These transaction requirements are driven by investor protection concerns. How does one measure or even begin determining whether a particular disclosure rule of the E.U. is the equivalent of our own in protecting investors? We believe convergence is the proper approach for transaction requirements.

Process

We conclude with a few thoughts on process. We believe, as does the Shadow Financial Regulatory Committee, that at some stage of the Dialogue there will need to be more structured governmental participation on both sides of the Atlantic. The U.S. and E.U. should consider

including the Commodities Futures and Trading Commission (CFTC) and state insurance commissioners on the U.S. side. The E.U. is increasing its focus on insurance and reinsurance regulation and the U.S. needs to provide input from its side. The E.U. also needs to have some member state representation. While E.U. financial regulation is significant, many important areas, like enforcement, are still left to member states. We should also consider whether this should be a U.S.-E.U. Dialogue or a U.S.-Europe Dialogue. If it is the latter, states like Switzerland, and even Russia, may need to be included in some fashion.

Toward a Single Transatlantic Market in Financial Services

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For several years the U.S. government has carried on an Informal Financial Markets Dialogue with the European Commission in order to narrow the differences between the different financial regulatory systems. The Shadow Financial Regulatory Committee believes that the time has come to consider the issues in a broader context: what would be required for the development of a single Trans-Atlantic market in financial services. Further, it is time to consider whether the present regulatory approaches make sense in a 21st century economy.

On the U.S. side, the Treasury has taken the lead in cooperation with the Securities and Exchange Commission (SEC) and the Federal Reserve, even though some of the issues involve other regulators. On the European side, the Commission has carried on the Dialogue without participation by member country regulatory authorities. As the name implies, the Dialogue is informal, with public disclosure limited to occasional speeches and fact sheets. Similarly, consultation with and advice from the private financial sector have also been informal.

Although the individual issues are well known to the private firms directly involved, the public policy dialogue has necessarily been limited. The Committee believes that the issues being discussed in this Dialogue are of importance not just to the financial services industry, but also to the U.S. and European economies more broadly. Although the governmental institutions and individuals involved are well informed and well motivated, we believe that the visibility of the issues under discussion needs to be raised but also to the U.S. and European economies more broadly. Although the governmental institutions and individuals involved are well informed and well motivated, we believe that the visibility of the issues under discussion should be raised.

The present Dialogue takes the substance of the existing regulatory schemes as given without conducting any cost-benefit analysis to determine whether particular regulations, either on the U.S. or the EU side, make sense in a 21st century economy. We believe that higher goals and broader economic examination of the underlying issues would be desirable.

From the standpoint of goals, the vision of a single Trans-Atlantic market in financial services will help to raise our sights and thereby the quality of the results. The economic benefits of recent financial innovation and transformation have been limited by outmoded regulation. And the costs of complying with the divergences among jurisdictions have been borne by private firms with predictable consequences for economic efficiency. We believe that the goal of a single Trans-Atlantic market in financial services, as well as the adoption of principles to resolve differences, would provide a framework for faster progress and greater achievement.

What follows is a summary of some of the key regulatory issues that confront the Dialogue, as well as a consideration of some principles that might guide agreement, and questions of process.

Some Regulatory Issues

First is the 2002 Sarbanes-Oxley Act, which extended new rules of governance to foreign firms whose securities trade in public markets in the United States. While SEC implementation of these rules has accommodated the principal concerns of European issuers, particularly in the area of the need for independent directors on the audit committee, certain issues remain. There is the question as to how the registration and inspection standards of the Public Company Accounting

Oversight Board (PCAOB) will be applied to foreign auditing firms. In addition, Europeans are concerned with the "no exit" feature of U.S. regulation that requires all companies with more than $10 million in assets and more than 300 shareholders to comply with Sarbanes-Oxley even if they were to drop their exchange listings and discourage trading of their securities in the U.S.

Second is the scheduled adoption of International Accounting Standards (IAS) by the EU in 2005, which may prohibit U.S. companies from continuing to issue securities in the EU under U.S. GAAP. It is not even clear whether countries currently trading under U.S. GAAP in Europe will be grandfathered. There is particular concern that the EU may not accommodate U.S. GAAP in the EU if the SEC fails to allow foreign firms to use IAS in issuing securities in the United States. While the Convergence Project undertaken by the Financial Accounting Standards Board and the International Accounting Standards Board is seeking to bring about convergence in the two sets of rules, it is far from certain that this effort will be complete by 2005. Complicating this exercise are important issues concerning which rules are adopted when they differ substantially and the balance between rules and principles.

Third is the divergence of views on the implementation of the Basel II Accord in 2007. The U.S. has indicated that it will apply only these standards to "internationally active" banks. The EU, on the other hand, envisions applying all of the standards to all banks and securities firms in the EU.

Fourth is the question of the effect of the EU's proposed Financial Conglomerates Directive on U.S. securities firms that are currently unregulated at the holding company level. The EU Directive would subject these firms to EU conglomerate regulation unless these firms are subject to "equivalent" U.S. regulation. The SEC has proposed a new form of holding company regulation, which it hopes will satisfy the equivalence test, but this has yet to be decided by the EU.

In addition, there are other areas of concern: different standards for data protection and privacy, the inability of EU stock exchanges to set up trading screens in the United States without being fully subject to U.S. regulation, differences in approaches to electronic trading systems, particularly those involving internalization, and differences in takeover rules.

Principles

If, contrary to our suggestions above, the Dialogue proceeds along its current narrower path, it would be useful to reach agreement on general principles to guide negotiations. Traditionally, the United States has followed the national treatment approach under which foreign firms operating in the United States are fully subject to U.S. rules, such as the requirement that foreign firms file reports using U.S. GAAP and comply with the CEO/CFO financial statement certification requirement of Sarbanes-Oxley. There have also been attempts to harmonize rules in formal ways, Basel II serving as a major example. To a great extent, the EU has adopted still another approach, mutual recognition, within its internal financial market. Mutual recognition requires the host state to recognize the validity of the home state's rules, assuming some minimum level of harmonization. The United States has generally been unwilling to accept mutual recognition principles in dealing with the EU, although it has adopted a mutual recognition system (with some important exceptions) with respect to Canadian firms issuing securities in the United States and to U.S. firms issuing securities in Canada. In addition, the United States has generally accepted home country regulation, albeit as a necessity, with respect to the regulation of foreign banks operating in the U.S. through branches.

Two other principles have been put forward more recently. First, the EU Commission has advocated an equivalence approach, whereby it would accept U.S. regulation that was equivalent to its own, even though the details might be quite different. Indeed, the Financial Conglomerates Directive adopts an equivalence approach. The United States has used the test as well in some areas. For example, foreign mutual funds registering in the United States are exempted from certain features of the Investment Company Act of 1940 if they are subject to equivalent rules abroad. Second, the SEC has advocated a convergence approach, indicating its willingness to accept EU regulation that has converged with but may not be identical to the U.S. rules. How these principles would actually be applied to the issues now under discussion has yet to be determined.

Process

As noted above, the Treasury, the SEC and the Federal Reserve represent the United States, while the European Commission represents the EU, even though other regulators may be consulted. At some stage there will need to be additional, more structured governmental participation on both sides, that would include the CFTC and state insurance commissioners on the U.S. side and key national regulators on the EU side, as well as self-regulatory organizations on both sides of the Atlantic. It will also be necessary to take into account non-EU countries in Europe, principally Switzerland. Discussions among government officials and regulators can result in more regulation as a "compromise". But

less regulation should also be an option in many areas and thus the views of private sector observers as well as the financial community should weigh heavily in the ultimate conclusions of the Dialogue.

Conclusion

The Shadow Committee applauds the efforts of the U.S.-EU Informal Financial Markets Dialogue to narrow the differences between the two financial regulatory systems. At the same time, however, we urge the participants in the Dialogue to raise their sights to achieve the more ambitious goal of developing a single Trans-Atlantic market in financial services. This approach should involve not simply an ad hoc resolution of current regulatory differences, but should involve a careful cost-benefit analysis of each aspect of regulation to ensure that we achieve a financial system that serves the real economy in the most efficient way.

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TESTIMONY OF
RICHARD E. THORNBURGH, CHAIRMAN
SECURITIES INDUSTRY ASSOCIATION

HEARING ENTITLED "THE US-EU REGULATORY DIALOGUE:
THE PRIVATE SECTOR PERSPECTIVE"

THE U.S.-EU FINANCIAL MARKETS DIALOGUE:
TRANSATLANTIC GOOD NEWS

BEFORE THE
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY POLICY,
TRADE AND TECHNOLOGY
JUNE 17, 2004

Madam Chair and members of the Subcommittee:

I am Richard E. Thornburgh, the 2004 Chairman of the Securities Industry Association[1], as well as the Chief Risk Officer for Credit Suisse Group, a member of the Executive Board, and ex-officio member of the Credit Suisse First Boston Operating Committee.

Thank you for your continued interest in the U.S.-EU Financial Markets Dialogue, and the European Union's Financial Services Action Plan (the "Action Plan" or the "FSAP"). I also thank you for giving me, and the Securities Industry Association, the opportunity to be heard on

[1] The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs 780,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated an estimated $209 billion in domestic revenue and $278 billion in global revenues. (More information about SIA is available on its home page: www.sia.com.)

these topics, which are of great interest to financial market participants in the United States and Europe.

My testimony today will focus on the critical importance of U.S. involvement in the development of EU capital markets. In particular, I will make the following points:

- The U.S.-EU Financial Markets Regulatory Dialogue is working – we need to build on what is now in place;
- The EU capital markets are both a critical source of investment capital for U.S. companies, and vital to U.S. investors, asset managers, and pension and mutual funds seeking portfolio diversification;
- Proper implementation of the "Action Plan" or "FSAP" is essential for the creation of an integrated, transparent, and liquid capital market; and
- We recommend a U.S. Action Plan to complement the implementation of FSAP including:
    - Placement of a Treasury Attaché in Brussels;
    - Increased inter-agency coordination – particularly utilizing State Department contacts in EU member states;
    - Formalized regulatory dialogue between the SEC and the Committee of European Securities Regulators (CESR) on regulatory convergence, as has been started; and
    - Greater Congressional/Parliamentary interaction.

The Dialogue is Working

I am especially pleased to testify today about the U.S.-EU Financial Markets Regulatory Dialogue. The securities industry believes that this Dialogue can be a starting point as well as an integral tool in promoting the best interests of the U.S. and EU economies and capital markets, including the development of an equity culture.[2] With the Dialogue in place, we believe it should be complemented with a coordinated U.S. inter-agency Action Plan (USAP) that can work with individual EU members states and Brussels to achieve FSAP goals: an integrated, deep, transparent and liquid European capital market.

[2] This will be critical if Europe is to stimulate the development of risk capital. EU Risk Capital Action Plan, http://europa.eu.int/comm/internal_market/en/finances/mobil/risk-capital_en.htm

The securities industry – both here and in the EU – has been a strong supporter of the FSAP. We have worked closely with the European Commission, the European Parliament and member-state regulators to help ensure that the Action Plan's objectives for a single, integrated, efficient EU capital market is realized. The FSAP is a considerable undertaking and we commend the continued commitment of member-state governments, the European Parliament, and the European Commission to this endeavor. I will discuss the FSAP's initial successes, which we believe are substantial, and certain aspects of the Action Plan, such as the Investment Services Directive (ISD), that we believe might have been accomplished differently if the Dialogue had been in place earlier.

Perhaps most importantly, I will address the future, and the desirability of building on existing capital-market linkages through a U.S.-EU regulatory-convergence dialogue. Not only are these issues important for the continued growth and integration of the EU's capital market and the broader transatlantic capital market, but also they are issues we believe will benefit greatly from the collective views to be offered by the participants to the U.S.-EU Financial Markets Dialogue. In this regard, we commend both the U.S. and EU for their consultation with SIA on capital-markets issues related to the Dialogue.

The FSAP (And The Dialogue) Are Important To U.S. Issuers and Investors

The U.S. relationship with the EU is extremely strong. Notwithstanding the inevitable disagreements that occur in a close relationship, the U.S. and EU have deep and ever-growing political and economic ties. The health of our respective economies is inextricably connected, with trade and cross-border investment flows linking the transatlantic economies and capital markets. The recent historic enlargement of the EU through the accession of 10 new Member States magnifies the region's importance to the United States.

This relationship provides the global U.S. securities industry and its corporate, institutional and retail clients with tremendous opportunities. Indeed, SIA's largest members engaging in global business receive about 20 percent of their net revenues (excluding interest) from European markets. About 35,000 European employees support these operations. Moreover, their revenues from Europe are close to double what is earned from their Asian operations. This is clear evidence that the largest U.S. firms are, in the truest sense, global in nature. Another example of the close financial linkages: six of SIA's top-20 member firms (as measured by equity capital) have European parents, including my own.

Fundamentally, the U.S.–EU relationship relies on building common social and public policy goals. The increasing closeness of the relationship is underscored in the statistics and the large trade in financial ideas, talent, technology and capital across the Atlantic; the nascent EU securitization market, U.S.-EU discussions on fair-value accounting and market structure, and improved EU consultation practices, to name just a few examples. In light of these linkages, we commend the Administration, and particularly U.S. Treasury Under Secretary Taylor, Assistant Secretary Quarles, and their staff for opening a specific dialogue with the EU on financial services issues.

The newly expanded EU – with 450-million potential investors and a Gross Domestic Product exceeding $8.6 trillion – is a key market for the U.S. securities industry and its clients.[3]

[3] The U.S. and EU equity markets combined account for 70 percent of global stock market capitalization. Not surprisingly then, our respective capital markets also benefit from the cross-border purchase and sale of securities. In 2003, EU-resident investors had transactions (purchases plus sales) in U.S. stocks and bonds of a record $12.8 trillion, resulting in their net acquisition of $225 billion of U.S. securities. Total U.S. transactions in EU securities amounted to about $4.3 trillion, a record, resulting in U.S. net divestitures of EU securities of about $7.6 billion.

The two-way flow of trade, portfolio, and direct investment between our two regions exceeds $1 trillion annually – more solid evidence of the partnership cemented between the U.S. and the EU. Importantly, the EU offers U.S. companies an alternative pool of capital for raising debt and equity capital. For example, in 2003 U.S. companies raised more than $171.1 billion in the EU capital market, of which $164.3 billion was in corporate debt issues, and more than $6.8 billion in equity. EU investors have a healthy appetite for U.S. securities and are a major supplier of capital and liquidity to the U.S. market. In 2003, EU investors acquired $225 billion of U.S. stocks and bonds; $33.6 billion in corporate debt, $170 billion of U.S. treasuries and agencies, and $21.3 billion in equity. Impressively, EU-based investors have added $1 trillion of U.S. stocks and bonds to their holdings since 2000.

The EU markets also provide U.S. investors with alternative investment options for purposes of portfolio diversification. For example, U.S. investors own more than $1.3 trillion in foreign stocks, of which over $712 billion, or 53 percent, are EU shares.[4] U.S. ownership of foreign bonds shows a similar emphasis. U.S. holdings of EU bonds totals more than $227 billion, or 45 percent, of total foreign bond holdings.

Without question, the U.S. and EU are each other's most important economic partner. U.S. companies, for example, get half their foreign profits from the European Union. U.S. direct investment in the European Union totaled $700 billion in 2002, and U.S. companies employed more than 3.3 million people in Europe (2001 data). EU investment in the U.S. is also significant. At the end of 2002, EU companies had direct investments in the U.S. totaling nearly $862 billion, or 64 percent of the $1.35 trillion total invested in the U.S. by all foreign nations. Moreover, EU companies based in the U.S. accounted for nearly 3.7 million U.S. jobs in 2001 (most recent data). Two-way trade in 2003 for goods and services totaled $589 billion, accounting for 23 percent of all U.S. trade volume. Clearly, the economic ties are substantial, and will continue to expand, particularly as the new EU accession countries prosper.

The rationale for the EU's Action Plan becomes clear when comparisons are made about market capitalization: the EU does not (yet) have a single financial market – it continues to be a

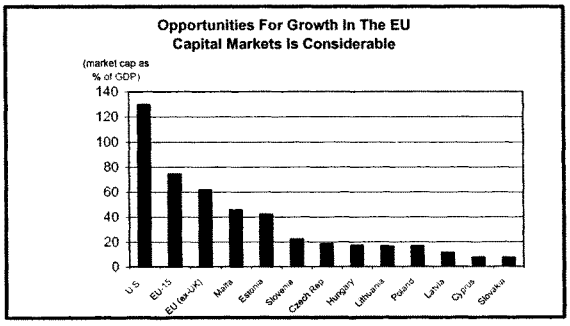
[4] The International Investment Position of the Unites States at Yearend 2002, July 2003, Survey of Current Business, U.S. Department of Commerce, Bureau Of Economic Analysis.

collection of national financial markets with an overlay of certain significant single-product markets, such as the Eurobond market. The result is that the EU's financial markets are still considerably smaller. By year-end 2003, the market capitalization of the U.S. equity markets totaled $14.3 trillion; almost double the EU total of $7.8 trillion. This tremendous potential for growth helped lead the European Union to conclude that integration of its financial markets should be a key political and economic priority. This, in turn, helped drive the development and pursuit of the FSAP.

U.S. securities firms have long participated in – and been committed to – the EU capital markets. They and their customers have participated directly in the gains that have been made to date, and expect to be among the primary instruments and beneficiaries of a more integrated, efficient EU capital market. The securities industry is extremely optimistic about the future of those markets and is committed to helping realize the full benefits intended by the FSAP.

Developing An Equity Culture

The FSAP, by integrating Europe's capital markets, will stimulate the demand and supply of funds to be intermediated by securities markets. This is critical because EU companies have, of course, traditionally been more dependent on banks for sources of financing through traditional loans. In fact, since the start of the EU single market in 1992, banking assets, as measured as a percent of Gross Domestic Product (GDP), have continued to increase, and ended 2002 at about 204 percent of GDP; the comparable number in the U.S. is 56 percent of GDP. By contrast, U.S. companies seek more capital for financing needs through the securities markets.



For example, the U.S. equity market is about 130 percent of GDP, while in Europe the comparable number is 74 percent.

Behind the FSAP lies the assumption that once the Action Plan is successfully implemented and enforced, EU capital markets will be more efficient, resulting in a broader pool of capital that can support economic growth and job creation. The FSAP will help to create an "infrastructure" for deeper and more liquid capital markets – but it alone cannot broaden the equity markets.

There are, in fact, promising signs of an emerging equity culture for investors in Europe. In the United Kingdom, one out of every three adults now invests in equities. In addition, institutional investors are also increasingly looking to build a greater equity presence by substantially increasing their equity holdings.[5] These trends and others bode well for EU investors and providers of financial products and services, as well as entrepreneurs seeking venture capital. As a result, the implementation of the FSAP – together with common internationally recognized accounting standards, the EU's corporate governance action plan, and improved efficiencies in clearing and settlement – will serve as a catalyst for the development of a Pan-European equity culture.

The recent U.S.-UK Enterprise Forum (May 24, 2004) was a great example of a bilateral attempt to share common experiences on developing a more dynamic "enterprise culture"[6] for which the development of equity investors is critical.[7] However, recent discussions by German

[5] An OECD study shows a similar trend. European holdings of stocks (as a percent of household financial assets) increased from 14.5 percent (1995) to 21.3 percent in 2000. During the same period, U.S. households increased their holdings form 32.0 percent to 33.1 percent. Household Wealth In The National Accounts Of Europe, The United States And Japan, March 4, 2003. http://www.olis.oecd.org/olis/2003doc.nsf/43bb6130e5e86e5fc12569fa005d004c/91e34dc3d290e515c1256cdf003fa444/$FILE/JT00140238.PDF

[6] U.S. Treasury Snow opening remarks to the Forum: http://www.treas.gov/press/releases/js1686.htm. Also, see: 1) Chancellor of the Exchequer Brown remarks at http://www.hm-treasury.gov.uk/newsroom_and_speeches/speeches/chancellorexchequer/speech_chex_240504.cfm; and 2) HM Treasury's website for "Enterprise and Productivity, http://www.hm-treasury.gov.uk/documents/enterprise_and_productivity/ent_index.cfm

[7] Also, note Results of the Competitiveness Council of Ministers, Brussels, 11th March 2004 Internal Market, Enterprise and Consumer Protection issues: "The Council adopted Conclusions welcoming the Commission's Action: The European Agenda for Entrepreneurship" as well as the progress achieved in implementing the European Charter for small enterprises. It identified a range of issues which now need to be taken forward, in particular helping to change attitudes to entrepreneurship through education and training, as well as ensuring that businesses can access the skills base they need to help them to grow; improving the flow of finance for small and medium sized businesses and seeing further progress in the

and French authorities to create "industrial champions"[8] illustrate the challenges that market forces face within the European Union, and contrast sharply with the market-oriented principles that underpin the FSAP, and could very well impede the ability to realize the full benefits of the FSAP.

Similar issues arose in the Investment Services Directive (ISD) debate on market structure. While the ISD eliminated the "concentration" rule, a number of EU countries supported pre-trade transparency provisions to protect local exchanges, which ran counter to goals of promoting greater competition, choice, and efficiency, and indeed might be a de facto concentration rule for certain transactions.[9] The U.S. must work together with its friends in Europe to bridge these differences within the EU and create the environment for private business to flourish, promote market reforms that empower investors and market participants, and allocate capital in a manner that maximizes growth, productivity, and job creation.

Overall, the success of the FSAP is important for the global economy. The U.S. and EU play leadership roles in the international marketplace, helping to set best practices, advocating open and non-discriminatory trade, and acting as engines for global economic growth and job creation. Ultimately, the success of the Action Plan will be determined by how it's implemented, interpreted and enforced by the European Commission and member states. Successful implementation of the FSAP – defined by its ability to create an integrated, deep, transparent, and liquid European capital market – is perhaps best viewed as a *perpetual annuity*.

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overall regulatory environment.
http://europa.eu.int/rapid/pressReleasesAction.do?reference=MEMO/04/58&format=HTML&aged=0&language=EN&guiLanguage=en

[8] UK minister hits out at EU "industrial champions", Financial Times, James Mackintosh, May 24, 2004. Also see, Let the market choose Europe's champions, "The key to prosperity is ensuring the right conditions for business investment, particularly in innovative sectors. An essential condition is strong competition." Financial Times, June 13, 2004 by Frits Bolkestein, EU Commissioner for Internal Markets.

[9] SIA letter to David Wright, December 3, 2003. Also see Linklaters' Financial Markets Group Briefing - April 2004, EU Agrees Revised Investment Services Directive, "However, ISD2 does introduce a new market making obligation for off exchange dealing, which is a significant restriction for those who currently deal as principal in the UK and which may act as a back-door concentration requirement for some transactions."

A U.S. Action Plan Is Needed To Enhance Financial Markets Dialogue

Looking forward at the next phases of U.S. engagement and the U.S.-EU Dialogue we would suggest a coordinated inter-agency effort – a U.S. Action Plan – to fully and effectively engage EU governments and regulators at all levels about the need for open and competitive markets.[10] As stated before, our goals include: establishment of a Brussels Attaché; increased coordination with the State Department; further U.S. Congress/EU Parliament contacts; and a SEC/CESR coordinated focus on regulatory convergence.

The implementation and enforcement phase of the key capital market directives at the core of the FSAP – as well as other topics under current discussion in Europe such as clearing and settlement, corporate governance, and the examination of rating agencies – will have a direct impact on the U.S. capital markets and U.S. financial services firms operating in Europe. Moreover, the Directives will affect U.S. corporation access to an essential pool of capital for years to come. To ensure that U.S. interests in the European Union are adequately represented, we strongly believe that the U.S. Treasury Department should place a U.S. Treasury Financial Attaché in Brussels. Such a post would advocate U.S. industry interests and support the financial-sector dialogue in which the U.S. and EU are now actively engaged.

A Treasury Attaché in Brussels would make possible much-needed day-to-day dialogue with the Commission and other EU decision-makers as implementation of FSAP progresses; would coordinate with the U.S. regulatory community as appropriate; and would both monitor and study developments of significance to the U.S. financial community in partnership with the industry. The expected pace of change in the EU financial market over the next years, and the complexity of capital markets legislation now in formation, justifies this type of focused presence at the center of the newly expanded EU.

And while we strongly believe a Treasury Attaché in Brussels is needed, we also believe the U.S. State Department, through its Mission to the EU in Brussels, and its Embassies and Consulates in all 25 member states, can enhance and support the U.S. Treasury Department's efforts on behalf of the U.S. financial services throughout the European Union. We believe this

[10] In Appendix A to this testimony we have detailed our views on the development of the Financial Markets Dialogue, and its importance to the U.S. securities industry

effort is essential because individual EU member-states can – and often do – play a pivotal role in key EU legislative decisions. Our experience with the Investment Services Directive made this point plain when the European Parliament's amendments to the proposed ISD were reversed (unhelpfully) by a political vote of finance ministers of the member states acting in Council. This reality, and the fact that FSAP measures will be implemented at the member-state level, calls for a U.S. government strategy in Europe.

Treasury clearly has the leadership role in the financial markets Dialogue. However, the State Department has Foreign Service officers with access to, and daily contact with, key government officials in all 25 EU member states – including each of the 10 new member states. Consequently, the State Department is extraordinarily well positioned to be an integral resource for the Treasury Department in these efforts. Increased focus by the State Department, in coordination with the Treasury Department, should therefore be a key element in enhancing U.S. engagement in the Dialogue.

In addition, we firmly endorse the further development of greater understanding and closer relationships between key financial services legislators in the U.S. Congress and the members of the European Parliament (such as the European Parliament Economic & Monetary Affairs Committee, the House Financial Services Subcommittee and the Senate Banking Committee). We believe these efforts should:

1) encourage constructive discussion of existing extraterritorial issues, such as the implementation of the Sarbanes-Oxley Act, and the EU's Financial Conglomerates Directive;

2) facilitate and encourage mutual prior consultation (an "early-warning system") on legislation with potential extraterritorial effects, to help prevent future conflicts; and

3) identify common future legislative goals and common or compatible solutions wherever possible.

Looking Forward: We Need Dialogue At The Regulatory Level On Convergence

The U.S. securities industry strongly supported the pro-active action taken by U.S. and European regulators as part of the U.S.-EU Financial Markets Dialogue – a new regulators' dialogue on regulatory convergence. To date, the Dialogue has been largely reactive, with the

U.S. and EU addressing – and resolving – a substantial number of serious and vexing regulatory issues. The current dialogue has been problem driven.

However, we, and the U.S. Securities and Exchange Commission along with the EU's Committee of European Securities Regulators have felt that the Dialogue should be employed for more than just solving problems once they have arisen. We have collectively concluded that the enhanced cooperation and understanding achieved to date can be used pro-actively for the purpose of minimizing regulatory differences or divergences and helping to make the transatlantic capital markets more efficient and accessible.

As a result, we welcome the SEC and CESR terms of reference for the cooperation and collaboration regarding market risks and regulatory projects.[11] SIA's support of such a pro-active "regulatory dialogue" is consistent with the industry's goal to minimize regulatory differences and improve the efficiency of the transatlantic markets through regulatory convergence.

To this end, SIA has proposed a number of discrete issues that we believe CESR, the SEC, and the industry, working together, could actually resolve in the near-term to the mutual benefit of the transatlantic marketplace. Indeed, in light of the increasingly linked transatlantic capital markets, an uncoordinated approach on these issues could only lead to new regulatory hurdles and barriers that would raise costs for all market participants.

SIA does not seek convergence for its own sake, nor do we believe that all regulations warrant convergence. Differences in our respective regulatory systems often reflect the realities of our different legal systems, different market structures and sometimes even different political choices. As House Financial Services Committee Chairman Michael Oxley noted in his opening statement at last month's hearing, "The choices one country makes for how best to protect its investors and depositors may not always coincide with the choices other countries make.

[11] SEC-CESR Set Out the Shape of Future Collaboration, June 4, 2004, "The enhanced relationship between the SEC and the members of CESR has two objectives. The first objective is improved oversight of U.S. and EU capital markets through increased communication regarding regulatory risks to enable regulators to anticipate regulatory problems more effectively. The second objective is to promote through timely discussion regulatory convergence with regard to future securities regulation." http://www.sec.gov/news/press/2004-75.htm

Different policies can be driven by differences in market structure. Such differences are legitimate and do not easily lend themselves to calls for convergence."

However, we do believe that different or duplicative regulation in service of similar or identical policy rationales only complicates the ability of market intermediaries, investors, and those seeking to raise capital to conduct business efficiently. Those areas in which we have suggested that the SEC and CESR study convergence are:

- public offering documents in the U.S. and European markets – beginning with non-financial disclosure, e.g. Management Discussion and Analysis, reporting of beneficial ownership, real-time event disclosure;
- U.S. and EU broker-dealer registration requirements;
- rules relating to credit rating agencies;
- international anti-money laundering standards that promote uniformity, cooperation and efficacy – beginning with the ability to rely on financial intermediaries across borders to perform due diligence, such as customer identification requirements; and
- corporate governance standards.

This list illustrates the serious and significant topics that Dialogue should address. Each is complex but provides an opportunity to eliminate unnecessary and unintended inconsistencies in regulatory requirements and, by so doing, contribute to more efficient capital markets.

Lastly, we will briefly discuss an issue of significant concern to the U.S securities industry, the EU's Financial Conglomerates Directive (FCD). In April 2001, the European Commission presented a proposal – a priority measure under the FSAP – for a Directive that would introduce group-wide supervision of financial conglomerates. The proposal was prompted by the continuing consolidation in the financial services sector that has created cross-sectoral financial groups with activities in both the banking/investment services and insurance sectors. The FCD was adopted in December 2002.

The UK's Financial Services Authority, as the "lead" regulator for virtually all major U.S. firms operating in the EU, will make the equivalence determination. It will do so using

guidance to be set forth by the EU Banking Advisory Committee taking advice from the European Commission. Originally, the guidance was to be announced by the end of April 2004, with the FSA scheduled to make its first set of equivalence judgments by June 2004. These timetables have slipped, and we are concerned that U.S. firms could face serious compliance problems. The ability to begin implementation of the Consolidated Supervised Entity regime that the SEC is carefully working on would be jeopardized. We urge the committee to monitor this situation carefully.

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The U.S. securities industry plays an important role in the EU capital markets and is fully committed to the integration of Europe's capital markets. Our competitiveness as a nation and an economy is supported by the ability of our financial services firms to compete openly and fairly. We look forward to working with the U.S. and EU on a positive economic agenda to ensure that European capital market liberalization is achieved in a non-discriminatory manner, and is transparent, efficient, and protects against risk. We very much appreciate the Committee's serious interest in the deepening relationship between the U.S. capital markets and those of our largest trading partner – the European Union. We look forward to working with Congress and the Administration as we work to help create the best possible foundation for the global capital markets.

Thank you very much.

Appendix A

The U.S.-EU Financial Markets Dialogue Is Only A First Step

The creation of a single EU financial services market – and the implementation of the Action Plan as a critical step in the realization of that objective – are significant undertakings. The issues raised are numerous and varied and, in many cases, reflect concerns shared on both sides of the Atlantic. While some of these transatlantic issues are a direct result of the Action Plan, others are not and have only been highlighted by the EU's major legislative program for financial services. Whatever their genesis, the Action Plan helped identify the critical need for a Dialogue between the U.S. and the EU focused specifically on financial services issues.

So, in December 2001, as the EU began to consider the specific details of key FSAP Directives, SIA's International Committee wrote to U.S. Treasury Under Secretary John Taylor supporting the creation of a new U.S-EU financial markets dialogue saying – and I quote:

> "The extensive capital markets linkages that have developed between the U.S. and EU make it all the more important that a more formal dialogue be established to supplement the ad hoc contacts that have existed and sufficed up till now."

The letter also said that the International Committee had recently met with John Mogg (Dr. Alex Schaub's predecessor as Director General of DG Internal Market) and had discussed with him the industry's concerns over the European Union's data protection, financial conglomerates, prospectus and market abuse directives.

It might be tempting to say that the familiarity of the items on that list, which looks not unlike a list one might make today, means that three intervening years of U.S.-EU Financial Markets Dialogue have not been very fruitful. But that would be a mistake. To the contrary, in common with the public sector witnesses from both sides of the Atlantic who testified before the full Committee on May 13, 2004, I am here to say that U.S. industry firmly believes that the U.S.-EU Financial Markets Dialogue is successful.

In the absence of the Dialogue, a substantial number of the items on that 2001 list might have easily degenerated into a disruptive – even ugly – "trade-style" dispute with potentially

disastrous consequences for both U.S. and EU financial services consumers. Instead, largely because of the Dialogue, each issue has been or is being resolved peacefully and sensibly by the relevant experts and professionals. And, success being the best of advertisements, new potential controversies have continued to be added to the list of issues the Dialogue is being asked to address.

And although the Dialogue was born of necessity – to provide a means of discussing and resolving issues caused by "overspill" – we believe that it should not be, and must not become, simply a means of "alternative dispute resolution". The industry has advocated the development of a dialogue that enables both partners to avoid to the greatest extent possible conflicts in the pursuit of solutions to what are, largely, shared concerns. I will revisit this point in greater detail in a moment.

The Financial Markets Dialogue Must Involve All Constituencies

SIA wrote its letter to Under Secretary Taylor in 2001 because FSAP-related measures, and other actions taken by the EU relating to the financial services, were directly affecting our ability to provide the products and services our customers worldwide demand, as well as our ability to maintain our international competitiveness.[12] And we were growing increasingly concerned that EU legislation, such as the Data Protection and the Financial Conglomerates Directives, could have a detrimental impact on the ability of our firms to compete.

As a result, SIA felt key government officials and regulators on both sides of the Atlantic should begin to discuss transatlantic capital markets issues on an ongoing basis, within an organized – but flexible, and informal – framework that would bring financial officials and regulators together to consult, to solve problems, and ideally to avoid problems before they arose. We were, in fact, concerned that without such a dialogue these complex regulatory issues

[12] For U.S. firms with a significant EU presence, FSAP Directives and other measure drafted and implemented could have a negative impact our ability to compete in Europe, and, even more worryingly, in other markets around the globe. In fact, we note that the EU Securities Expert Group Report (May 2004), recommends that European legislation and regulation better take into account the fact that investors and issuers frequently taken decisions on a global basis. The Group further notes that the prospectus and transparency directive, while helping integrate the pan-European market, may "...reduce the willingness of third country issuers and investors to raise funds and allocate capital in Europe." Financial Services Action Plan: Progress and Prospects", Securities Expert Group, Final Report, May 2004.

could lead to tensions or even trade disputes that would impede the efficient flow of capital between the two regions.

For that reason SIA was extremely pleased that government officials at the 2002 U.S./E.U. Summit in Washington, D.C. announced a financial markets dialogue that would include all relevant financial markets participants – a group whose members would change as appropriate depending on the particular issue being addressed.

At A Glance:

I.U.S. – EU Transatlantic Financial II.Markets Dialogue

	EU Participants	*US Participants*
Financial Markets Dialogue	EC	Treasury/SEC/FRB
Securities Regulators	CESR	SEC
Congress/Parliament	EMAC	House Financial Services Committee

CESR = Committee of European Securities Regulators
EC = European Commission
EMAC = Economic and Monetary Affairs Committee

The Dialogue's recent efforts have been notable and successful with a broadening of participants. They include, of course:

- The work by the SEC and the European Commission to mitigate the extra-territorial impact of the Sarbanes-Oxley Act;

- The graceful resolution of concerns over PCAOB registration for which we congratulate Director General Schaub and PCAOB Chairman McDonough, and;

- The very practical solutions to the Transparency Obligations Directive's accounting standards requirements – grandfathering certain existing bond issues – that will avoid a threat to the liquidity of the European markets against the backdrop of coming accounting standard convergence.

One area where earlier conversations with U.S. market regulators and market participants might have been helpful is in connection with the EU's efforts to update its rules relating to market structure. In our view, the Commission's numerous attempts to balance the merits of pre- and post-trade transparency and on- and off-exchange trading during the revision of the EU's Investment Services Directive could have benefited from greater, deeper, and earlier familiarity with the full range of experiences (both good and bad) of the U.S. markets. Consequently, SIA member firms and U.S. regulators spent a great deal of time with the Commission, EU regulators and legislators helping to craft a compromise ISD revision that seeks to balance, even if imperfectly, the requirements of retail and institutional markets and participants.

Now, with 39 of the 42 FSAP directives and measures introduced and agreed to, the emphasis within the EU (both in Brussels and at the member-state level) will shift to the implementation and enforcement stages. We expect this shift to highlight transatlantic issues that will have to be dealt with imaginatively if the FSAP is to deliver the desired benefits to issuers, investors, and consumers of financial products. It is therefore increasingly important that Congress, the Administration, and U.S. financial services regulators continue and even enhance their engagement in European capital markets developments.[13]

[13] Financial Market Dialogue: United States financial officials, including representatives from the Treasury Department, Securities and Exchange Commission, and the Federal Reserve, are engaged with their E.U. counterparts to ensure that European capital market liberalization is achieved in a non-discriminatory manner and are market transparent, efficient, and protect against risk. http://www.useu.be/TransAtlantic/U.S.-E.U.%20Summits/May0202WashingtonSummit/May0202U.S.E.U.PositiveEconomicAgenda.html.

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